

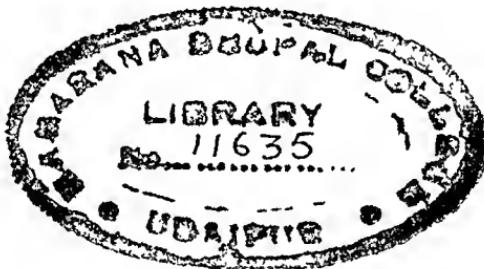
# JUSTICE IN TAXATION IN INDIA

WITH SPECIAL REFERENCE TO BRITISH GUJARAT

By

D. T. LAKDAWALA

University School of Economics and Sociology



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# **STUDIES IN INDIAN ECONOMICS**

**by**

**C. N. VAKIL**

**University Professor of Economics, Bombay**

# WAR AND THE MIDDLE CLASS:

*An Inquiry into the Effects of Wartime Inflation on  
Middle Class Families in Bombay City.*

by

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D. T. LAKDAWALA

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## TRADE UNIONISM IN INDIA

by

S. D. PUNEKAR

(In Print)

(New Book Co.)

Indian labour problems have assumed a great importance in Indian economic life, but Indian labour, as a branch of Indian economics, is so far a comparatively neglected subject. For example, we have as yet no detailed study of the Indian labour movement. This book is an attempt to make good this deficiency. The author has made a firsthand study so as to bring out the special problems of organised labour in India. He also discusses a number of concrete problems demanding immediate solution like the need for an Indian Labour Party.

## EDITOR'S PREFACE

In the Central Budget for 1946-47, the Finance Member announced that a Taxation Enquiry Committee would be appointed in the near future for a fresh comprehensive review of the tax system. He observed that 'one important object of the proposed enquiry would be to secure, as between the various classes of taxpayers, an equitable distribution of the burden of taxation.' We have no systematic study of the burden of taxation on different classes of taxpayers, and it is not clear whether the proposed committee will undertake a detailed statistical inquiry before arriving at conclusions, or will work on general data. We say this because the complexity of the problem is generally not realised. It may be mentioned that Sir James Grigg, a former Finance Member, in answer to a question in the Legislative Assembly promised that the then newly appointed Economic Adviser to the Government of India would be asked to make a study of the incidence of taxation on different classes of people in the country. Dr. Gregory (now Sir T. E. Gregory) made a scheme which is not published; but in this connection, he took into confidence those likely to help, particularly Heads of Departments of Economics of the Universities. It was understood that the inquiry would require the collection of sample family budgets throughout the country of different classes of people and that the effects of taxation on the people would be studied with reference to such data. This elaborate and costly but essential piece of work would have taken some time, but would have been of great help for bringing about an equitable distribution of the burden of taxation. For reasons which are not known, the study was abandoned.

The present work by Dr. Lakdawala is the first systematic attempt in the same field. As the capacity of an individual research worker in respect of time as well as money is limited, the investigation was confined to British

Gujarat. It was known that though it would not be possible to establish guiding conclusions in all cases, it would be possible to evolve a method which other research workers might find useful. The publication of the work which was completed in June 1943 has unfortunately been delayed due to the difficulties of paper and printing. In spite of this, this first attempt at a systematic study of the problem of tax burdens on various classes of the people will, I am sure, be of high value at the present juncture, when this question is likely to engage the attention both of the Governments and the public.

This work was first done in this School as a thesis for the Ph.D. degree of this University, but has since been considerably revised by the author who is now a member of its staff.

School of Economics and Sociology,  
University of Bombay,  
22nd June, 1946.

C. N. VAKIL

## INTRODUCTION

The real skill of a Finance Member is not tested under those happy circumstances when there are budgetary surpluses and the taxes can be reduced or abolished, but in that unfortunate situation when he labours under the compulsion of having to find fresh sources of revenue;\* for he has then to perform the task of taxing and pleasing at the same time—a feat, which a great writer pronounced to be as impossible as of loving and being wise in the same breath. The Finance Members in India have had to perform this odious task for the last so many years. The earlier budget-framers at the Centre and the Provinces did not feel these difficulties in full force owing to their irresponsible constitutional position. But the various Finance Ministers of the provinces after 1937, owing to their being members of popular ministries, which had to cater simultaneously to the people's demand of being less taxed and more cared for, felt this strain much and chafed heavily under it. Though their difficulties were in part due to their limited powers over the services and the inadequacy of tax resources given to the provinces, they are also to a great extent inherent in the situation of an economically backward country like India, and are likely to persist, and even increase, in a post-war free India. Many of the present war-time resources of taxation will disappear after the war but a large part of the present increase in defence expenditure is likely to become a permanent feature of the Indian financial system. A heavily mechanized army, a powerful navy, and a mighty air force will be indispensable to post-war India. Retrenchment, Indianization, rationalization and conscription will offset only a part of this increase. To add to this, if India wishes to be anywhere near her rightful place in the post-war world, she will have to make a tremendous allround increase in her

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\* Cf. Green—*Taxation in Theory and Practice*, pp.3-4.

social services. Her development services will also have to be considerably expanded. The State policy in spending more on economic development and on social improvements will certainly bring in a handsome return. There will be, as a result of State action, an increase in National Income in due course, and therefore the existing taxes at the same rates may yield much more than they do now. But this process will take some time, perhaps a fairly long time. The interval will be a trying period. While a part of the gap between revenue and expenditure may be met by borrowing during the transition, some part will have to be met by tapping fresh sources of revenue or increasing rates of existing taxes. The Finance Ministers of the future will have to continue this odious duty of taxing for some time more to be able to avoid inflationary gaps.

In finding out new sources of taxation, our Finance Ministers will have to exercise great caution and skill. There is a powerful opinion in the country, which believes that the Indian people had reached their taxable capacity even before the war. One may not agree with it, but none can gainsay that the burden under Indian conditions was fairly heavy, and any increase in it must be made with a careful consideration of the shoulders that can bear the burden. This becomes all the more essential when even the pre-war taxation was suspected of being ill-distributed.<sup>1</sup> It is, therefore, very essential that the burden of the existing tax structure on the various Indian classes should be closely studied so as to furnish a sound basis, on which alone a correct taxation policy can be built up. This will enable the future Finance Ministers, if not to please, at least to allay public discontent. In its absence, the temporary political exigencies will dictate the policy. Unfortunately, however, there is no work giving authoritative data on this subject. Nor is there a possibility of any such work without the collection of data regarding national in-

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1. The ex-Finance Member, Sir James Grigg, was only echoing the general sentiment in India, when he said on many occasions that "the taxation system in this country is regressive, that it lets off the rich too lightly, and that it taxes the poor too heavily"—Assembly Debates, 1938, p. 1656.

come and its distribution, regarding production and consumption of various commodities, and without a study of family expenditure on taxed items. Only the State can attempt the collection of such voluminous statistics; but the State in India has consistently fought shy of such work. The solution of the problem cannot await till the State gathers sufficient courage. In the meantime, as a practical scientist, it is the economist's job to wrest the most out of existing data or such data as can be collected, and help in the formation of economic policy. Even if conjectures and surmises are essential, he cannot flee from the task, as by training he is the most fitted to make them. This work is the first effort to enable the economist to perform this task under the existing handicaps. We have confined ourselves to the task of measuring the distribution of the tax burden in British Gujarat—a narrow homogeneous tract in which we could collect a sufficient number of representative budgets to get an idea of the consumption of various classes of people. The canons of war taxes are different from those of peace taxation, and it is hard to allot the burden of many war taxes. The choice of a war year for the purpose of calculating the burdens was, therefore, out of question. The last pre-war year, 1938-39, was obviously the best choice. Not only was it the last year of peace, but also the year in which conditions in India were normal, no efforts having been made to harness the national economy to war purposes. Our calculations of the burden of taxation have, therefore, been made for the year 1938-39. By itself this study cannot have more than a methodological value. But if it is followed up by similar studies in other regions, considerable valuable data will be accumulated without any State help and a fuller, though rather faint, picture of the tax distribution in India will be possible.

The knowledge of the distribution of tax burden is of use only in so far as the user has some well-grounded ideal of tax distribution, in the light of which the tax structure is to be judged. We have, therefore, discussed in Chapter I the principles of justice in taxation, even though it may appear to be a question more of ethics than

of economics. A large amount of literature is available on the subject. Our Chapter is only a judicious selection of the principles of distribution that have appealed to us, along with a discussion of the full implications of these principles and their limitations under our conditions.

Having thus arrived at some definite ideas regarding the distribution of tax burden, we pass on in Chapter II to the device to measure the tax burden—the technique of incidence. A great part of this chapter is devoted to a discussion of the meaning of this term. Seligman himself, who contributed a great deal to the terminology in this realm, and was greatly instrumental in differentiating incidence from various allied concepts, gives no clear cut meaning or definition. The Colwyn Committee, the next best authority on the subject, are no better guide. We have, therefore, been forced to forge out a definition of 'Incidence' for our purpose. Following Dalton we have looked upon 'Incidence' as a device to measure the direct money burden of the State taxes, and have concluded that there can be no specific burden without a corresponding revenue to the Government, and every pie that goes to the Exchequer must have a corresponding incidence. So defined, incidence seems a very narrow concept, and doubt arises regarding its value. We, therefore, pass on to discuss at length the limitations of the study of incidence, and its utility in spite of these limitations. This discussion as well as the earlier discussion in the chapter of methods of escaping taxes are mainly based on Seligman.

A study of the incidence of taxes is an essential preliminary to the study of the burden of the tax system as a whole. Part II, consisting of chapters III to VIII, contains an examination of the incidence of various taxes in general and of Indian taxes in particular. Every chapter in this part is broadly divisible into two parts, the one dealing with the theory of incidence relevant to the tax under examination and the other treating the incidence of the tax in India. Though on the theory of incidence there is a voluminous literature, it has seldom been brought toge-

ther anywhere. The only book that deals with the subject as a whole, viz. Seligman's, was written as early as 1899. Many of the prevailing taxes did not exist then, or were of minor importance. Hence they seldom got anything more than a passing reference, e.g., the incidence of income tax and death duties was not thought worthy of any serious discussion by him.<sup>1</sup> The Colwyn Committee had the fortune of doing the work much later and devoted serious attention to the study of incidence. They gave considerable space to a discussion of the incidence of the above two taxes. But even this is out of date now. The sales tax, which the Committee condemned without any discussion, has assumed an important place in the world financial system, and none can now dare dispose of it in one paragraph. Various sorts of business taxes have grown up, which the Committee could not foresee. Even regarding the two taxes, whose incidence the Committee discussed at length, they were singularly unlucky. Their view of the incidence of the income tax has been one of the most controversial parts in their report. Their opinion regarding the incidence of death duties aroused no such violent controversy, but is unacceptable to many. The remaining literature on the subject of incidence is so scattered, that we thought that a theoretical discussion, even if it were only based on the available literature, would serve a useful purpose. Moreover, most of this literature suffers from the lack of a clear definition of incidence. The clear definition adopted in this book gives us an initial advantage.

The portions relating to India in the different chapters of Part II stand in little need of apology. They deal with the incidence of the various taxes in India, and their injustice, if any, to individuals, classes and groups. Any discussion of tax effects or administrative practicability is

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1. In the later editions of the "Shifting and Incidence of Taxation", he did not devote any greater attention to this topic. In "The Income-Tax" published in 1911, he did not touch this problem at all. Later on in 1924, he wrote an article discussing this problem, which was published as appendix XII to the Report of the Committee on National Debt and Taxation.

rigidly excluded; only, where necessary, references have been made to them. The history of various taxes is also kept out as far as possible. In spite of these exclusions, these portions, a careful reader will note, overlap to some extent with books discussing Indian taxes in all their aspects and ramifications. This is only because in the absence of any data regarding effects of taxes or of expenditure, or of adequate knowledge of administration, even comprehensive studies on taxes are bound to degenerate into vague discussions of their justice. Even at such places of overlapping, we submit that the unity and concentration of purpose in our work lend it a value of its own.

Having studied the incidence of various taxes individually and the injustice they create, the important task is to put the result synthetically and to point out how the whole tax structure affects the various income groups, for these are the most important classes in our Society, and any injustice among them ought to be the special concern of the State. Part III is devoted to this work. A complicated technique has been built up in Britain and U.S.A. to perform this task. To study this technique at work, the various assumptions it had to work upon, the degree of precision it could acquire, and the changes wrought out in it in order to make it suit the more complex tax structure of modern times, we devote Chapter IX to the various incidence studies made in U.K. and the one in U.S.A. This examination of foreign studies prepares us for the final plunge which we take in Chapter X. In that chapter an attempt is made to evolve a method that similar studies should follow in India by an effort to measure tax burden in Gujarat. The family budgets specially collected by us in the cities and villages of Gujarat are perhaps better guides than those of other countries, because of the fact that our budget items were specially selected for the purpose of studying incidence of taxation. In other respects, however, our study suffers in comparison with foreign studies. The absence of adequate data regarding production of

- various commodities and the lack of figures regarding the distribution of national income have landed us often into great difficulties. We have had to adopt many devices to get round them, with the result that we can claim for our figures only a rough approximation to truth. As an apology for our work, we can only quote the words of Sir Herbert Samuel, the founder of incidence studies in Great Britain: "In choosing it (the measurement of tax burden) as the topic,....., I am fully conscious of its difficulty. On a number of points, particularly with regard to several of the indirect taxes, the material for exact statement is far from adequate. We are compelled to proceed largely by estimate. If this were not so, however, if the subject presented no difficulties, if the facts were easily ascertainable, we should find the allocation of taxation set out in the Blue Books, and there should be no need for this Society to trouble itself about the matter..... By collecting the facts, wherever facts are available, and by framing estimates, where we are obliged to have recourse to estimates, on as broad a basis of facts as possible, we may hope to reach results that will be serviceable. These results cannot be free from error; they cannot claim acceptance in details; but taken as a whole, they will indicate, I believe, with substantial truth, the broad feature of the situation."<sup>1</sup>

Our great thanks are due to the University of Bombay for their substantial grant towards the cost of publication of this work.

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## CHAPTER I

### JUSTICE IN TAXATION

PARADOXICALLY enough, the modern civilization has, along with its breaking up of old class solidarity and social harmony based on the principle of rank by birth, also brought in a new and deeper awakening of social consciousness. The New Age is characterized by not only a greater emphasis on individual rights, but also by a better realization of obligations and duties to society. The members of the "Great Society" are distinguished not only by their greater clamour for justice to themselves, but also by their ready, though so far grumbling, acceptance of the dictates of justice even when it goes against them.<sup>1</sup> This willingness of the people to do unto others as they would be done by has naturally made itself felt most in relations of the individual to the State, especially in countries where the popular form of government has been accepted.<sup>2</sup> Since taxation is one of the most important fields, where the ordinary individual comes into direct contact with the State, the desire for justice has made itself most felt in this sphere. The huge increases in public expenditure in pre-war years<sup>3</sup> have lent great strength to the ethical desire.<sup>4</sup> The fear based on past experience, that at least a part of the present colossal war increase in expenditure may become permanent, makes this problem of the just distribution of tax burden more urgent than ever before.

1 Witness the acquiescence of the rich in a steeply progressive income tax. It seems they have realized the truth of the old Chinese maxim, "The pitcher has been exhausted; it is the shame of the jar."

2 See Adams, Science of Finance, pp. 321-322.

3 For some interesting figures, see Green, The Theory and Practice of Modern Taxation, pp. 304-314.

4 Cf. "Taxation is now rapidly developing from a merely unpleasant incident into a dominating feature of daily life, and those features which have hitherto been of little interest, because they have been too small to matter, now become of great importance." Stamp, The Fundamental Principles of Taxation, pp. 1-2.

Considerations of practical utility lead to the same conclusions. It is a well-known law of mechanics that even a light load, if ill-distributed, may prove too heavy to bear. So also a small amount of tax revenue, raised by means of ill-conceived taxes, proves a serious menace to national progress; nay, it may lead to popular resentment, and may ultimately drive the people to revolt.<sup>1</sup> Thus, not only the principle of the conservation of social energy but also the narrowest grounds of self-interest compel in the State a regard for justice in levying even light taxes. A load, that amounted to more than 20 per cent of national income in pre-war years<sup>2</sup>, and may be heavier in the post-war period, has to be distributed with the greatest care and discrimination. The time has now come, when the most ardent adherent of the theory of so plucking the feathers of the goose as to make it squeak the least has to pay some regard to justice.

## II. Various Canons for the Just Distribution of Tax Burden

Unfortunately, this acknowledgment of the claims of justice does not help us much, for equity in tax matters is yet an elusive concept. We have yet not been able to furnish a unanimous reply to the doubting Pilate's persistent question, "What is justice in taxation? What is meant by a just distribution of the tax burden?" The answer to this question has varied with times, places and persons. We shall examine some of the more important replies to this query to see whether we can arrive at some satisfactory, answer.

### (i) Cost-of-Service Theory

Of all the theories evolved to lay down how a just distribution of the tax burden<sup>3</sup> could be best achieved,

1 One of the important causes of the French Revolution was the French tax system with its exemption of, or with its letting off very lightly of, the clergy and the nobility. Hence, the popularity in those times of the slogans "Universality of Taxation" and "Proportional Taxation."

2 Green, pp. 301-302.

3 The word "tax" is, throughout this chapter, used in a non-technical sense, and covers all the ways in which the State finds money for meeting its expenses.

that appealing the most instantaneously is the cost-of-service theory. According to it, the basis of tax payments is the services of the State to the individual. Proceeding on the analogy of individual dealings, it argues that just as to be fair in his transactions the seller ought not to charge the buyer anything above the cost price of the service or the commodity he deals in, so to achieve justice in taxation the State must take from every subject by way of taxation the cost of its services to him.<sup>1</sup> It is acknowledged by the supporters of this theory, that since the services of the State have to be in most cases universal within its borders, it cannot give its subjects the option of going without its services, and it has to make compulsory charges for them. But this, it is contended, is no reason why the principle recognized as fair in dealings among individuals should be modified in any other respect in the dealings between the State and its subjects. Nay, the very reason that the State has to enforce its payments on all should make it more careful to see, that, in levying its charges it does not depart from this accepted canon of fairness.

### Application to Security Services

This theory attracts us at first sight both because of its apparent simplicity and its conformity with the practices of a commercial age. But its application is fraught with the gravest difficulties. Most of the State services, especially the security services, are so general, that it is impossible to ascribe specific costs to individuals. Who can say what part of the military or police expenses is incurred for the protection of a particular individual? Even with regard to other protective functions of the State, that ap-

1 "In all these cases (gradual development of communities) there is one simple principle by which the contribution of each colonist is determined; every one pays in proportion to the expense incurred by government in protecting him. Just as he pays the shopkeeper for the goods he buys, the lawyer for the advice he asks, the ploughman for the labour he hires, so he pays the government for the protection he receives and the amount he contributes is not regulated by the colonist's ability to pay, but by the cost incurred by government on his behalf." Sargent, quoted in Seligman, *Progressive Taxation in Theory and Practice*, pp. 167-168.

pear to be undertaken for particular persons only, e.g., bringing to book a criminal offender who has done some harm to the person or property of another, this rule does not admit of any application.<sup>1</sup> On closer examination even here the common interests are seen to be so interwoven with individual benefit,<sup>2</sup> that the recovery of the expenses incurred in the discharge of these functions from the persons directly benefited is unfair. These defects perhaps could be removed by the evolution of a suitable technique. But that would not help the theory much, for its application would flout our cherished concepts of justice. Though we have no means at our disposal to form any exact quantitative judgment with regard to the costs of the primary functions of the State incurred for different individuals, it is easy to see that the State has to undertake more expenses on behalf of the aged, the weak, the children and the women. The State has to spend proportionately more on the property of the poor than of the rich. The protection of a property worth a lakh in the hands of one rich person costs much less than that of a hundred pieces of property, worth a thousand rupees each, owned by a hundred persons. Properties of equal value require different sums for their protection according to their forms, according to whether they are movable or immovable, tangible or intangible.<sup>3</sup> The principle of charging according to cost, when applied to security services, will thus lead us to regressive and unequal taxation. Under it the meek will be punished; and those that have will contribute unequally.

#### Application to Social Services

With regard to social services, the idea is even more untenable. The cost-of-service theory is based on a contractual conception of the State. The very inception and growth of the social services is only made possible by a theory of the State, which is in irreconcilable antagonism

<sup>1</sup> Cf. "The value of government to any man is proportioned to the completeness of the protection it extends to all men." Cooley, quoted in Adams, p. 324.

<sup>2</sup> This is recognized in the category of non-compoundable offences found in criminal laws of almost all the civilized countries.

to this concept. The State performs most of these services, precisely because many of the persons benefiting from them are not in a position to pay their full costs. Private hospitals, private schools, and private dispensaries usually give ample facilities to those, who can afford to pay for their services. It is only because a large section of the people cannot pay for these, and yet in modern opinion from the larger viewpoint they must get these services, that the government takes upon itself the duty of providing them. Unless it did so at a charge less than the cost price, there would be no meaning in its undertaking them. This is even more true with regard to Unemployment Relief and other direct State help to the poor. These forms of State expenditure are out of place and ridiculous in a State trying to allocate its tax burden according to the cost-of-service theory. But the idea of the State being a family, where it is the duty of the abler or more fortunate members to look after their unfit or unfortunate brothers, has become so ingrained in our minds, that not the greatest conservative among us dare plead for an abolition of, or even a great reduction in, these services. We have, therefore, to reject the cost-of-service theory. 1

### Real Sphere of Application

The rejection of the claim of this theory to govern the tax system as a whole should not be taken to mean that there are no spheres, in which this rule can be profitably applied. In certain cases, as for instance extra taxes in special pressure zone, this principle is rightly observed. This rule is also widely obeyed in fixing charges for the services of the commercial departments run by the State.<sup>2</sup> In justice to the proponents of this theory, it must be remembered that though to-day it is pronounced on all hands, as impracticable and undesirable, there was a time when it was only the recognition of an existing fact.<sup>2</sup>

1 The mere fact, that the State derives no profit from all commerce department, is no proof of its observation of the cost-of-service principal in that realm. For a fuller discussion, see Chapter VIII.

2 Bastable, Public Finance, p. 208.

### (ii) Benefit Principle or "Give and Take" Theory

This theory is only a variant of the "cost-of-service" theory. Whereas the latter theory looks at the problems of fairness in taxation from the viewpoint of the society, the former adopts the individual's standpoint. The latter is derived from the principles of a commercial society when looked at from the supply side or the sellers' viewpoint, the former when the same principles are viewed from the demand side or the buyers' viewpoint. It must be borne in mind that this theory does not require that the amount of taxation imposed on an individual must equal the value of the benefits he receives from the services of the State. The worth of State services to an individual is incalculable.<sup>1</sup> Even the lowliest among us enjoy a considerable consumer's surplus in their relations with the State. What the theory really implies is that the total tax burden should be so distributed among the citizens, that each of them pays that proportion of the total State expenses, which his benefits bear to total benefits.

### Benefit Theory and Security Services

In spite of its alluring nature and patronage by the great, this theory provides a basis for taxation impossible in practice, and entirely in contradiction with modern ideas. Its greatest advocate<sup>2</sup> has tried to reduce it to a canon of proportional taxation,<sup>3</sup> an easy "rule of three." But such a result does not seem to follow logically from the theory. The advantages that a person derives from the police State are not confined to the revenues which he enjoys under it. They also include the much more valuable protection of the person and the invaluable cultural life made possible by the existence of the State. Von Hock pointed out that while for the protection of property a proportional tax might be considered as answering the needs of the benefit

<sup>1</sup> Weston, *Principles of Justice in Taxation*, p. 166.

<sup>2</sup> Adam Smith. Though he used the word "ability" in his celebrated maxims of taxation, he really meant benefit. See Seligman, *Progressive Taxation in Theory and Practice*, pp. 164-5.

<sup>3</sup> As usual with Smith, some inconsistent passages pleading for progressive taxation are also found in his book.—Seligman, p. 165.

theory, for the protection of person and for sharing in the welfare of the commonwealth, a poll tax looked much more reasonable.<sup>1</sup> A closer analysis, however, reveals a fatal flaw even in this modified position. The real measure of the extent of benefits accruing to an individual because of the State lies in the probable happenings to him in its absence. Visualizing the results of the lack of an effective government machinery is today largely a matter of conjecture and speculation, and therefore leaves room for widely differing opinions. A glance at past history, however, will convince one that in the event of the disappearance of a vigorous State it is the poor, who will suffer the most. If for any reason the State ceases to exist or to function effectively, the rich can afford to hire watchmen and employ detectives for the protection of their persons and property. Nay, if they feel so inclined, they can even harm others' persons and snatch away their property with the help of hired goondas. The poor will have to rely on their own unaided strength, and will therefore be beaten in the game. A few unscrupulous adventurers among them may profit by the disorder of the times, and taste of the forbidden riches. But for the overwhelming majority, it only means an intensification of their miseries. Thus, a regressive tax for protection of property, and a tax varying inversely with health, youth and vigour for personal protection—this would be the tax system organised on the benefit plan.

### Benefit Theory and Social Services

To the social services provided by the modern State, the benefit theory cannot be applied at all. The advantages of free cultural facilities like education, museums, libraries, exhibitions, recreation grounds, etc. accrue only to those who are capable of benefiting by them. The extent of the advantages varies widely even among those few, and is again a question of individual capacity, industry and luck. Many of these benefits are purely psychological, and are

<sup>1</sup> See Weston, p. 127.

not reflected in any increase of earning power. The task of applying the benefit theory in this sphere has, therefore, to be given up as hopeless.

To do full justice to the theory, it must be admitted that, there are certain social services whose benefit to particular individuals can be easily ascertained, e.g., with regard to the Old Age Pensions or Unemployment Allowance, there can be no difficulty in measuring its advantages to any individual. But to think of the application of the theory here would appear funny. These services had better been not performed than performed by taxes gathered on benefit principle.<sup>1</sup>

#### Proper Sphere of the Benefit Theory

The benefit theory, though inadmissible into the entire field of taxation, finds its just application in case of some taxes. Where the actions of the State benefit a particular section of the people, and the section so enriched is not regarded as a fit object for government subsidy, the State is justified in charging the individual benefited the full value of his benefits. For instance, as a result of the war declared by the State, many individuals, firms and companies make fabulous profits. The declaration of the war is not, or at any rate ought not to be, inspired by the desire to enrich these sections.<sup>1</sup> The State may, therefore, take away the whole of these war profits. Though administrative reasons make this ideal very difficult of attainment, many States have come very near this ideal. The unearned increment land taxes and the U.S.A. Special Assessments are based on this principle. The Motor Vehicle Taxation in United Kingdom obeyed this rule for some years.<sup>2</sup> However, the sphere, *par excellence*, of the benefit theory is local taxation. Many causes contribute to this. Defence

<sup>1</sup> As Simons sums up, "Where expenditure is made for purposes of general welfare (national defence, internal security), the benefit principle leads nowhere at all; and, where the Government undertakes deliberately to subsidize certain classes (the economically unfit) or certain kinds of consumption (education, recreation), taxation according to benefit is sheer contradiction."—Personal Income Taxation, p. 4.

<sup>2</sup> Silverman—Taxation, Its Incidence and Effects, pp. 11-12.

against external aggression and maintenance of internal law and order are outside the purview of local bodies. Most of the services local bodies render are economic in character, and can be exactly measured. Their voluntary services like water supply and electricity can, and must be rendered, on the benefit principle; even their compulsory services like street lighting, fire-fighting, etc., are rightly charged in accordance with it, for they increase the earning power of the property owners. The small size of the area concerned makes for a greater sense of responsibility among the local electorate, and for an easy linking up of the taxes with services rendered. But even here, the application has never been whole-hearted, and modern developments are restricting its scope. Local bodies devote an increasing part of their total expenditure to social services, and as we have seen earlier, benefit canon is not suited to these. The main benefit of some of the services rendered by local bodies goes to the country or the province as a whole, and recognizing this the central or the provincial governments liberally subsidize these services. But State taxation, as we have seen, cannot proceed on the benefit principle. Moreover, as the size of the local unit is increasing and its functions multiplying, the connection between the burden of the tax and the benefit of the service rendered from its proceeds becomes less obvious.

The scope of application of the benefit theory has become narrowed down in modern times. But its important role in history must always be gratefully remembered. Crude and unrefined as it may sound us to-day, it represented a great advance on the practice prevailing at the time of its inception of exempting the clergy and the nobility from taxation.

### (iii) Ability Theory of Taxation

The theory, that commands the greatest measure of agreement today, is the ability theory. laying down that each person shall contribute to the State coffers in proportion to his ability. Though a part of its great appeal is due

to the pleasant vagueness of the word "Ability" and the consequent possibility of attaching many meanings to it, much of it stands on more solid ground. 'Ability is the "ideal ethical basis of taxation."<sup>1</sup> The ability theory expresses so fully and obviously what Cohn calls "the broad principles of moral solidarity,"<sup>2</sup> and fits in so well with the modern conception of the State, that it commands spontaneous and almost universal allegiance.'

#### (a) Production Side or Ability Proper

The principle of ability may be viewed from two sides, the production and the consumption sides. <sup>1</sup> The production viewpoint is based on President Walker's definition of faculty as "the native or acquired power of production."<sup>3</sup> While the native power varies with individuals the acquired power increases with an increase in the amount of property or income. Money, as the proverb says, makes money. Riches, to a great extent, obey the law of increasing returns. It is just that the State should take into account the greater opportunity to make more money that riches confer on an individual. The correct tax system will, therefore, mean a progressive tax on property or income. <sup>4</sup>

While recognizing the truth of the two fundamental assumptions contained in it, viz., that the first few coins are the hardest to acquire and after their acquisition the task of earning more becomes easy, and that every member of the society is duty-bound to make utmost efforts for his complete development, the theory has to be given up because of its entire impracticability. As a guide to a tax system, the theory cannot be accepted, for it lays down no

<sup>1</sup> Weston, p. 172.

<sup>2</sup> "The more fundamental phases of the public activity in some degree condition the very existence of the individual in society, so that it appears right and just that these fundamental conditions of human social life should be intimately bound up with the total personal and economic strength of each individual. The appeal to the principle of the pecuniary ability of the individual in matters of national concern touches our sense of equity so directly and irresistibly because it is a principle of wider scope than that of the economic field alone, and is but a special application of the broad principle of moral solidarity."—Cohn, quoted in Weston, pp. 172-3.

<sup>3</sup> Walker, "The Bases of Taxation," Political Science Quarterly, (1888), p. 14.

quantitative measure. It hints at the necessity of some progression in the tax system, but as to the degree of progression we ought to achieve, it furnishes no clue.<sup>1</sup> The element of potential faculty being immeasurable, this must necessarily be so.

### (b) Consumption Side or Sacrifice Theory

The impracticability of measuring ability in this sense compels us to view it from the other side—the side of consumption. Ability, in its fullest sense, includes not only the power of production, but also the capacity of enjoying its consequences. This second aspect, forgotten by earlier writers, has been developed by later ones. The ability theory as viewed from this aspect is called the sacrifice theory of taxation. It must be admitted at the outset with Weston<sup>1</sup> that the word "sacrifice" connotes something negative, something wrested under compulsion. It, therefore, ill fits in with the modern positive concept of the State. Yet, to deny this theory is to turn a deaf ear to the entire march of progress made in the theory of public finance, and to refuse the help of the only rudder that years of painstaking research have given to us.<sup>1</sup>

### Marginal Utility of Money

The essence of the "sacrifice" theory in its manifold variations is that all taxation, since it means deprivation of money, involves some sacrifice.<sup>1</sup> The problem of justice in taxation is the problem of how best to distribute this sacrifice. As to the exact way in which this end should be achieved, no agreement has been arrived at among its adherents, and many variants of the theory have sprung up. But all these views have to assume some relation between wealth and welfare based on an analysis of wants.<sup>1</sup> It is now almost universally accepted, that the law of diminishing utility, i.e. the law that the more the person has of a commodity, the less valuable he regards future increments of it, holds good also in the case of

<sup>1</sup> Weston, pp. 207-8.

money.: The utility of money is only a derived one, and since the intensity of wants diminishes as we pass from necessities to comforts and from comforts to luxuries, the marginal utility of an additional unit of money diminishes with every addition in riches.: But the universal command over goods and services, that the possession of money gives, makes the fall in the utility of money very gradual, and its social worth prevents it from falling to zero. Popular parlance in considering the widow's mite as valuable as the rich man's gold reveals a fine grasp of this principle. It is not possible, however, to lay down exactly the quantitative diminution in the marginal utility of money at each stage.<sup>1</sup> All, that is possible, is a rough statement regarding the fall in marginal utility at broad stages of income. Until the fundamental necessities of food, clothing and shelter are satisfied, the marginal utility of money is immeasurable. One is apt to part even with his birthright for a mess of pottage. This statement holds only with slightly less force with regard to conventional necessities. As we pass from the satisfaction of necessities to that of comforts, the utility of money goes on decreasing. It falls more rapidly, when a greater proportion of money is devoted to buying of luxuries. As we go higher up the income-scale, the fall in utility continues, but the curve becomes less steep as the difference between the intensities of extra wants satisfied at two successive stages of income goes on lessening. Thus, after a certain level is reached, the rate of decrease in marginal utility of money goes on decreasing,<sup>2</sup> until at a certain stage it becomes negligible, almost nil.

### Equal Sacrifice Theory

Having examined the marginal utility of money, we are now in a position to evaluate the different sacrifice

<sup>1</sup> Attempts have been made in this direction, e.g., the laws of Bernouilli stating that utility diminishes in inverse ratio to means.—Edgeworth, Papers relating to Political Economy, Part II, p. 108.

<sup>2</sup> Cf. "The utility of the last pound diminishes rather rapidly in the early increments of income after the essential needs of life have been satisfied; then the rate of diminution tends to be slower, as the distinction between bare sufficiency and elementary comfort gives way to the slighter distinctions between lesser and greater comfort, and between comfort and luxury."—Report of the Committee on National Debt and Taxation, para 332.

theories of taxation. The more widely accepted sacrifice theories have been those of "equal sacrifice" and of "minimum sacrifice." According to the first, the money burden of taxation should be so distributed that the real burden on taxpayers is equal. This theory would require, that from those who have more, more shall be taken. ; The actual rate of increase in taxation will depend on the assumed rate of diminution in the marginal utility of money. If we assume that the curve indicating the marginal utility of money is a rectangular hyperbola, the system of proportional taxation, will satisfy the criterion of equal sacrifice. If the curve is supposed to be flatter, the system of taxation necessitated would be regressive. If the curve is thought to be steeper, progressive taxation would be essential. The last assumption regarding the curve is in best accordance with facts. Since the sacrifice imposed by deprivation of necessities is immeasurable, the subsistence minimum should be left untaxed. For the first few increments of income after the exemption level the rate of increase of the tax will increase rapidly, but will slow down soon, and finally become nil at that point where the difference in marginal utility at two successive points becomes imperceptible. In this connection it must be borne in mind that many of the wants satisfied by higher incomes are relative.<sup>1</sup> The rich man often feels the loss of certain commodities, only because many other rich persons use them, and their use has come to be the badge of their tribe. If deprived alone of these, he would suffer greatly and perhaps gloat over his personal misfortunes and social injustice. But if his entire class were to be denied their use, his suffering will be greatly reduced, or even be entirely absent. Thus, the fact, that the modern tax system will affect persons of same incomes equally, justifies a much greater degree of progression in the higher income stages, than would be warranted by the curve of the marginal utility of money to an individual, drawn on the assumption that his social compeers remain unaffected.

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<sup>1</sup> See Pigou, The Economics of Welfare, (1st Edition), pp. 48-49.

### Minimum Sacrifice Theory

More logical and in greater harmony with the modern theory of the State is the doctrine of minimum sacrifice, which requires that the tax system should be so devised as to reduce the discomfort, the misery and the sacrifice imposed by taxation to a minimum.<sup>1</sup> The purpose of the State is to maximize the aggregate welfare of the people. Since tax measures cannot further well-being in any way, the best they can do is to cause the least inconvenience.<sup>1</sup> This requires that the marginal sacrifices borne by all taxpayers should be equal. Assuming that the relation between wealth and welfare is uniform for all taxpayers, this would demand that the higher grades of income should be so lopped off as to reduce them to the lower ones, before the latter are touched. Logically, the system ought to proceed further. If there is not enough taxation "to go round" and reduce the people to the dead level of complete equality, the right policy for the government to follow would be a combined course of taxing the rich and subsidising the poor to the extent essential to achieve this goal.<sup>2</sup> If, however, we do not want to go to this extent for some reason or another, the policy of not touching any lower grade of income, unless all the higher grades have been brought down to it, must be strictly adhered to.

### Variations in Individual Needs

It must be remembered that the principle of equi-marginal sacrifice only leads to this conclusion, if we assume that the tastes and needs of all persons are alike. But this assumption is not true. There are persons content with a very simple life, for whom any income above the subsistence level is utterly useless. On the other hand, there are many to whom cultural requisites are as essential, as the barest physical needs of existence.<sup>1</sup> Perhaps, a large part of this difference is only due to the difference in upbringing and surrounding, and is apt to change with

<sup>1</sup> Edgeworth, Vol. II, p. 103. The terminology here is Benthamite.  
<sup>2</sup> Pigou—A Study of Public Finance, p. 76.

changes in environment.<sup>1</sup> But a part of the difference is also inborn. Unfortunately the State cannot take these individual variations into account except in a few cases, where some external index is available. In these few cases, the modern tax systems do pay heed to the different needs of the different taxpayers. The most important instances of this are the marriage and family allowances given in almost all civilised countries. A person with a family has greater needs than a bachelor. These needs vary not only according to the size of the family, but also according to its age composition.<sup>2</sup> The latter is too detailed a consideration to be taken into account; but the tax systems of most of the civilized countries have income tax allowances for the wife, children and dependants of the family head. There is also another important variation in needs which it has been found possible to allow for. If future wants are taken into account, a person with an earned income will feel the loss of Re. 1 more than another man with an equal amount of unearned income. The earning capacity of the former may be adversely affected any time. Accident, sickness or old age may render him unfit for work; changes in taste, technological changes, the failure of his firm and, above all, the periodic crisis may deprive him of his employment without any fault of his own. Death may lay its icy hand on him any moment, leaving his family helpless. He must put aside a part of his present income for such contingencies. A man with an unearned income is under no such compulsion. His future income is fairly secure; for his family there is already a fairly good provision. He and his family have, if need be, capital to fall back upon. In order, therefore, to secure equi-marginal sacrifice, 'unearned income' is taxed at a higher rate than 'earned income.'

1 See Chapman, The Utility of Income and Progressive Taxation, The Economic Journal, 1913, pp. 28-29.

2 Cf. "It is manifestly absurd to assume that a family with 4 daughters in high school or college can live as well on the same income as can a family with 4 children under 10 years of age."—King, Journal of Political Economy, Vol. XXIX, p. 583.

### III. Modifications in the Minimum Sacrifice Theory Production Considerations

**Effects on Labour:** Unfortunately, to the very satisfactory theory (from distributional point of view) of equality by taxation, and even to the modified proposal, of not affecting lower incomes until the higher incomes have been pruned to their size, there are serious objections. The laws of distribution are not, as Mill imagined, something apart from the laws of production.<sup>1</sup> The tax system affecting distribution is bound to have repercussions on production, and a change in distribution so revolutionary as would be implied by the application of this proposal to modern tax systems is likely to produce some startling effects on production.<sup>1</sup> Even on the amount and willingness of physical and intellectual labour, where the effects of a heavy taxation are acknowledged to be the least, this policy may have disastrous effects.<sup>1</sup> The hope of financial gain is even now the most powerful incentive to regular and persistent efforts to put forth one's best.<sup>1</sup> For the maximization of national dividend, it is absolutely essential that every additional dose of effort must have some remuneration. To deny this reward is to sap the most important root of wealth. The tax system must, therefore, leave the higher incomes higher.<sup>1</sup> It is hard to say anything exact about the degree of inequality that must be permitted to secure the best result. The influence of the monetary and non-monetary motives on men's willingness to work are yet an unsolved problem in social psychology. But much of the inequality that is thought necessary at present can certainly be dispensed with.<sup>1</sup> In all higher types of work the desire of public or group distinction, the healthy feeling to outshine fellow-beings, the aesthetic desire of excellence for its own sake and the philanthropic motive of social service play a very important role, and these are capable of being further strengthened by a change in environment.<sup>1</sup> The fact that all similar incomes will be hit equally introduces an entirely new factor in the situation depriving all present ob-

<sup>1</sup> See Hobson, *The Social Problem*, pp. 107-110.

servations of much of their value. The salary, which a business firm must pay to an expert to retain his services, is much higher than the reward that society would have to offer to him in order to prevent him from turning into a grave-digger. The gain, which an industry must promise to a manager in order to attract him, is greater than the reward that society would have to pay to induce him to utilize his abilities rather than let them lie hidden and unused. |The State would, therefore, be certainly able to go forth much further in the tax policy demanded by minimum sacrifice theory without affecting adversely the willingness to work than would seem possible at first sight. |

The ability to work will, on the whole, be affected favourably by the envisaged tax system; but even here some modifications will be essential. | A surgeon must spend much more than a barber to keep himself fit for his profession. If the tax system leaves him with no more money than the barber, his capacity for work will be reduced. It is, therefore, essential that if "necessaries of efficiency" differ for two persons, the State must impose taxes in such a way, that the necessities of one are not touched before the superfluities of the other are taken away. |

**Effects on Capital:** The effects of the proposed tax system on the supply of capital are more certain and more alarming. The desire and willingness to save and the factor of risk-taking may or may not be seriously affected; but the ability to save will severely decrease.<sup>1</sup> | Most of the savings in our present society are automatic, made by the rich because of the excess of their incomes over their customary standard of life. If their earnings are reduced, it is their savings, not their expenditure, that will have to bear the brunt of reduction. | The people benefited under the tax system are more likely to spend the excess of their

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<sup>1</sup> Cf. "The social utility, in fact, only begins when the income is sufficient to leave a margin over necessary expenditure; in other words the special utility to the community only begins, when the greatest utility to the individual has ceased." Report of the Committee on National Debt and Taxation, para 333.

income rather than save it. Thus, any tax system leading to less inequality will affect the supply of capital adversely. There are, however, some modifying considerations. The amount of capital saved by companies forms a significant proportion of the total savings of the community. These company savings are the result of entirely different considerations, and are less liable to decrease with decreases in inequality.<sup>1</sup> In addition, the actual directions of State expenditure will have a considerable bearing on the effects of the proposed tax system over the supply of capital.<sup>2</sup> Where a considerable portion of revenue is devoted to the payment of interest on National Debt, since a large amount of the government loans are likely to be held by the rich, the "least sacrifice" principle can be carried much further. Where the State provides a good part of business capital,<sup>3</sup> the principle can be enforced more rigidly than elsewhere. Moreover, the reduction in material capital may be compensated for by the betterment of human capital due to better provision of social services. In spite of these qualifications it is clear that if adverse effects on capital supply are to be avoided, our proposed tax system will have to be greatly modified. Perhaps, we may find more social welfare in less wealth more equally distributed, but that is a choice to be very cautiously and deliberately made.<sup>4</sup> At any rate, we must be conscious of the danger, that by insisting too much on the principle of minimum sacrifice, we may so contract national dividend that the poor become poorer. The possibility of that grim choice between "unequal distribution of wealth" and "equal distribution of poverty"<sup>5</sup> must be fully contemplated.<sup>6</sup> "Progress and justice are costly luxuries—costly, above all, in terms of each other."<sup>7</sup> But care must be taken to reconcile them,<sup>8</sup> for in

1 *Ibid.*, paras 392-402.

2 *Ibid.*, para 444.

3 For a discussion of certain advantages of state extension of enterprise see Wedgwood, *The Economics of Inheritance*, pp. 20-22.

4 *Ibid.*, p. 4.

5 Simons, p. 21.

6 As Pigou says, it is quite possible to show these production considerations as only a logical extension of "equi-marginal sacrifice" theory—*A Study in Public Finance*, p. 76.

the long run both find their justification in social welfare.

### Regulation Considerations

The principle of minimum sacrifice is, it must be remembered, a corollary from the principle of the realization of the greatest good. Where the two seem to be in conflict, the second must prevail.<sup>1/</sup> Prohibitive rates on intoxicants, a tariff policy with a view to future rapid industrial development, and other such measures avowedly meant to regulate can be justified, even when they violate the "least sacrifice" principle.<sup>2/</sup>

### Administrative Considerations

Administrative practicability is the first *sine qua non* of all tax measures and systems.<sup>2/</sup> An excellent and ideally just tax system, if incapable of enforcement, may lead not only to public irritation and ill-feeling, but even defeat its own aim. Measures looking less just but capable of being properly administered will prove juster in the end. Very often, we have to rule out a tax measure only on the ground of its unworkability, and rightly so. But a word of caution is essential. The administrator's task is not only to point out the impracticability of otherwise just tax measures, but also to improve his technique as to make practicable all the complexities in tax measures which our growing insight into justice necessitates.<sup>1/</sup> His work is not only to exercise a veto on tax measures, but also to so develop his art that the use of the veto becomes more and more sparing. The great progress, that can be achieved through a determination to work out upto the standards of equity, is manifest in the history of the income-tax.

1 Cf. "It must, indeed, be admitted that no test which is centred in sacrifice, in the sense of loss of satisfaction, goes quite to the root of things. For, of equal satisfactions, one may embody more good than another; as between a greater and a less sacrifice of satisfaction, the greater may carry the smaller amount of evil. When this happens, it is, of course, the aggregate of good and evil, not the aggregate of satisfaction and dissatisfaction, to which a wise government will look."—*Ibid.*, p. 57.

2 "On all sides we are realizing the fact that the question of efficiency is scarcely, if at all, subordinate to the question of justice." Seligman, Essays in Taxation, p. 332.

#### IV. Conclusions

' We have thus seen that the principle of contemporary equi-marginal sacrifice will have to be considerably modified in practice.' The quantitative limitations that we should place on our maxim in light of these modifications cannot be even roughly worked out, so that M'Culloch was not wrong, when he asserted that when once the proportionate principle was abandoned we were at sea without rudder and compass. Even a very painstaking enquiry like the Colwyn Committee's can give only some indications of the extent in progression to which the State can go.

' A method of trial and error, a boldness in experimentation, combined with the scientific spirit of watching carefully and improving readily, and a feel for the ways of the world —these alone can enable us to evolve the right tax system. But three distinct rules can be laid down here. '

##### (i) Exemption of the Subsistence Minimum

We have seen that on the grounds of equi-marginal contemporary sacrifice, no lower incomes ought to be taxed, until all higher incomes have been reduced to them. ' The considerations of production lead to important modifications in this theory. But, in the case of the minimum of subsistence,<sup>1</sup> the considerations of justice and distribution are only reinforced by those of production. ' Not only does the deprivation of something, from the person who has just sufficient to keep body and soul together, mean immeasurable pain to him which no ecstasies of others can compensate, but it also means a great undermining of the human constitution with greatly adverse effects on the immediate and the remote future.<sup>2</sup> '

The same cannot be said so confidently of persons able to purchase the conventional necessities, but not comforts. A tax on them may compel the earners affected to reduce

<sup>1</sup> In cases, where the state itself supplies free or at concessional rates some necessities, the subsistence cost for individuals will be correspondingly lower.

<sup>2</sup> It must be remembered that net earning, standard of life, and efficiency often move in a vicious circle.

or eliminate their expenditure on the conventional necessities so that the State will get its proceeds without disturbing the taxpayers' efficiency. On the other hand, the consumption of these conventional necessities may be maintained intact, and the tax may be met by reducing the expenditure on necessities. In this case, the tax will prove as harmful as the one on the absolute minimum. Only a detailed consideration of the immediate circumstances with regard to each specific proposal can furnish an answer, as to which result will ensue.

The principle of the exemption of the subsistence minimum has so much force behind it that it has been often preached even by those believing in taxation according to benefit.<sup>1</sup> The only objection to this exemption, that has appealed at all to the modern mind, is one urged on political considerations.<sup>2</sup> It has been argued that civic consciousness can only be roused, and the necessity of spending wisely can only be impressed on persons through the exaction of taxes from them. To this strange logic based on the premises that mankind can learn through suffering only, a detailed reply is unessential. It is only necessary to point out, that the need to pay taxes seems to be a very poor arouser of social wisdom as our greatest taxpayers are often men least interested in the State, and that the demos, when aroused, is as likely to curtail expenditure foolishly as wisely.

<sup>1</sup> It is unfortunate that while lip recognition has been given to this principle, it has not been observed anywhere in practice. While in direct taxes it is a practice to exempt incomes or capital below a certain minimum, commodity taxation is rarely so devised as to exempt them.<sup>2</sup>

### (ii) Taxation of Windfalls

Another rule that will stand all criticism is the taxing of windfalls at cent per cent. Even when they accrue to the poorer classes,<sup>2</sup> since they are unexpected and unde-

<sup>1</sup> Seligman—*Progressive Taxation in Theory and Practice*, pp. 183-193.

<sup>2</sup> Pigou seems to lose sight of this in his remarks in para 2, p. 177, *A Study of Public Finance*.

served, their deprivation means little pain and no injustice. In the modern society, most of the windfalls only make the rich richer. Since they are not the reward of any economic service, no production considerations deter us from carrying out our theory to the fullest limit of practicability. Very similar is the case of rents and other quasi-rents (surplus costs), which may have been foreseen, but which, since they cannot affect any future supply, may be taxed without any fear of adverse effects on production.

### (iii) Steeply Progressive Rates

While we have ruled out the "acme of socialism" in spite of its fulfilling the condition of minimum sacrifice on the ground of its effects, we must have as steep a progressive tax system as the consideration for maximization of welfare (not only wealth) would permit. In framing our tax system too much caution should not be exercised, for after all, the effects of the State taxation on distribution are certain, a matter of arithmetic, those on production problematic, a question of social psychology.<sup>1</sup> If an error need be made, the safer is in the former direction. Hitherto, the tendency has been in the opposite direction, and this ought to be corrected. Human psychology is so complex, the motives to work so hidden and complicated, and the possibility of its modification in a different environment so great, that a steeply graduated tax system must be tried.<sup>2</sup> The possibility of necessity proving the mother of invention and the State stepping forth to fulfil the role of private savings ought to make us bolder.

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<sup>1</sup> Simons, p. 19.

<sup>2</sup> During the war, this has been largely done.

## CHAPTER II

### INCIDENCE OF TAXATION

#### I. Some Preliminary Notions

We have devoted the whole of the previous chapter to a discussion of the ideal distribution of the tax burden, and have mentioned the various considerations that should be taken into account in deciding this. But no determination of this, however correct, is of any practical use, until we forge an implement wherewith we can measure the burden of a tax system, existing or proposed, and decide how far it conforms to the ideal. This is by no means an easy task. It has long been recognized that taxes are not always borne by those, on whom they are levied. The distinction between direct and indirect taxes is as old as Mill<sup>1</sup>, who made it turn round the legislator's intention. But that no longer satisfies us.<sup>2</sup> We refuse to accept the intention of the legislators as the criterion of the nature of a tax, for we know their astounding ignorance of economics.<sup>3</sup> Even if our rulers could be so perfect as to exactly fit their means to their ends, that would be of little use by itself, for we no longer believe in maintaining a fixed ratio between the direct and indirect taxes.<sup>3</sup> We know that there are direct taxes and direct taxes, and indirect taxes and indirect taxes. We do not regard indirect taxes as always deserving condemnation, or direct taxes as always deserving commendation. Poll

1 "A direct tax is one, which is demanded from the very persons who it is intended or desired should pay it. Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another."—Mill, *Principles of Political Economy*, p. 823.

2 Cf. Dalton, *Public Finance*, pp. 34-35.

3 The most well-known instance of this is Gladstone's budget speech of 1861, wherein he compared the direct and indirect taxes "to two attractive sisters, who have been introduced into the gay world of London, each with an ample fortune, both having the same parentage" to both of whom he, as the Chancellor of the Exchequer, felt an act of duty to pay his addresses—Quoted in Shirras, *The Science of Public Finance*, pp. 297-98.

taxes are direct taxes, and much of the commodity taxation after the 1914-18 war has been levied on articles of comfort and on luxuries. We have, therefore, to wade our way through a complicated analytical apparatus<sup>1</sup> before being in a position to pronounce any opinion on a tax system.

### Illegal Evasion

Any person, on whom a tax is imposed, usually makes vigorous efforts to escape it.<sup>2</sup> The tax burden, even when small, is felt to be so opprobrious that all human ingenuity has been employed to go scot-free. And many ways have lain open to the intelligent and the daring. The most time-honoured method has been to act in defiance of tax laws, taking adequate precautions not to get caught. Smuggling and illicit traffic have long been known in history. Tax-dodging is even now not uncommon. But this method involves grave risk. If caught, the individual is likely to suffer public disgrace, heavy penalties, and often imprisonment. The odds against him are becoming heavier with an increase in the efficiency of government.<sup>3</sup> Moreover, the habit of obedience is greatly growing among the governed. This method, therefore, is decreasingly resorted to. Even now, however, if the tax is heavy, and defiance of the law not very risky, widespread resort to this method cannot be ruled out.

### Legal But Illegitimate Evasion

The more prevalent method of evasion is to satisfy fully the letter of the law, while defying the spirit of it. The history of income tax law is full of such instances.<sup>3</sup> The devices of one-man partnerships, of formation of private

1 Cf. "The equitable distribution of taxation involves the insoluble problem of incidence."—Report of Sir Edward Hamilton and Sir G. Murray in Royal Commission on Local Taxation (1901), p. 109.

2 Cf. "In the payment of taxes no man is a patriot ; every person endeavours to evade them, or to oblige others to reimburse him for what he pays."—Adam Dickson quoted in Seligman's *Shifting and Incidence of Taxation*, p. 153.

3 The history of death duties or of the excess profits tax equally abounds in such instances. Vide Wedgwood, pp. 230-245, and Haig, *The Taxation of Excess Profits in Great Britain*, pp. 147-149.

companies<sup>1</sup> which do not distribute dividends and store up reserves beyond reasonable needs of business, the apparent transfers of property to wife and children, the creation of bogus firms—all these and a multiplicity of other devices depending on the exact wording of the law have been employed to escape tax payment. Governments have not been found wanting in the desire to tighten up such loopholes, and have at times even endowed the officers with wide powers of discretion, e.g., in many countries income-tax officers have been given the power to decide whether the amount taken to the reserves of a Company is excessive, and thus *prima facie* with a view to evade the shareholders' super-tax. But so complicated are the provisions of a modern tax law, and so many are the tax experts whose justification is in showing their clientele how to pay the least amount of taxes compatible with safety from the clutches of law,<sup>2</sup> that every statute however well-thought-out has been found to contain at least some clauses through which a partial escape can be made.<sup>2</sup> This battle of wits is much influenced by the spirit of the nation and of the times. Where it is felt that the tax is unjust and people do not look down upon the tax-evader,<sup>3</sup> the battle is likely to be fought to the bitter end. Where the justice of the tax is realized, and where any evasion is looked upon as theft, this practice will be resorted to less frequently. This is one of the reasons why a rate of tax, which would, in normal,

1 "Why,—in the words of a Chancellor of the Exchequer—everybody, from a peer downwards, converts himself into a private company."—Sir F. Palmer quoted in Wedgwood, p. 231.

2 This is not to say that every case of illegitimate evasion is inspired by fraud. "He (the evading tax-payer) may not always be guilty of fraud; he may be culpably careless; he may decide every doubtful point in his own favour by deliberately refraining from inquiry; he may cultivate a profitable ignorance or a negligence that is not free from guile. His conduct may, in short, occupy any position in the scale, from something less than complete honesty down to absolute fraud. The one common feature in all such cases is that the Revenue suffers, which is only another way of saying that the evader contrives to make his fellow-citizens pay something that ought to have come out of his own pocket."—Report of the Royal Commission on The Income Tax (1920), para 625.

3 For the attitude of people of some of the leading nations of the world to tax evaders, see Green, pp. 146-147.

times, turn the whole nation into a nation of liars, is found possible of smooth administration in war-times.

### Legitimate Evasion

Besides these two illegitimate methods of evasion, there is also a legitimate one. When a tax is levied on a commodity, some of the individuals affected may reconsider their position, and decide to consume less of it, or even go without it. A tax on a cheque will make some people resort more to cash transactions; a tax on receipts will make some people willing to rely only on the honour of the other bargaining party, and take the risks of law rather than get a valid stamped receipt. The legislatures often impose a tax on a commodity or a transaction precisely to discourage its use. High taxes have often been levied on liquor to minimize the evil of drink; imported products are frequently heavily taxed with a view to encourage indigenous industries. In such cases, the evasion is called intentional evasion; in other cases, the evasion is unintentional.<sup>1</sup>

### Shifting of the Tax

But legitimate evasion, whether intentional or not, involves a painful change in the consumption habits of long standing. The more usual method, therefore, of escaping taxation is that of passing the tax on to others. This method, unlike the others, yields revenue so that the State is not much worried about the problem<sup>1</sup> and the battle can be fought out without any fear of the State's weight being thrown against any party. The imposition of each tax is a prelude to a struggle between the consumer, the producer, and the intermediaries, each striving to throw the burden on another. Take, for instance, the case of a retail sales tax of 5 per cent being imposed on cloth. The cloth-merchant, not liking to be made the beast of the burden, may decide to raise the prices of all varieties of cloth by 5 per cent. If he succeeds in so doing, the consumer pays

<sup>1</sup> It may happen that reasons more powerful than tax productivity may make a government anxious to see that a particular tax is or is not shifted. See Chapter VII.

the tax, and he is said to have shifted the tax on to the consumer. Perhaps, however, he may think that the reduction in cloth-sales or the loss of goodwill of his customers consequent on a rise in prices will be such, that the higher price will not be worthwhile; or having already charged higher prices, he may find out his mistake. His failure to shift the tax to his customers will make him think hard of any less strong line of resistance, and he may discover it in the wholesaler, to whom now he will pay less than the previous price. It is essential to distinguish this second process from the first,<sup>1</sup> where the tax was shifted to the consumer. The first process is known as shifting forwards, the second as shifting backwards. It is quite possible that in our second instance the wholesaler, while thinking it to his advantage to submit to the price reduction demanded by the retailer, may, in his turn, attempt to shift the tax still backwards, say to the millowners. Think now of a contrary process, an excise duty on production of cloth collected from cloth mills. The mills, in order to avoid reduction in profits, may pass on the duty to their wholesale purchasers or agents, who, in their turn, may shift the tax on to retail dealers, and they to the final consumers. This is known as the process of shifting onwards.<sup>2</sup>

### Tax Capitalization

As contrasted with these cases of shifting, where only a single tax is shifted, there are instances where a series of tax payments, before any of them except the first has been paid, is passed on to the seller. Suppose, for example, that the railway shares yielding 5 per cent interest are being bought and sold at par. This means that when factors like security and other advantages of railway shares are weighed along with the rate of interest, the investors think that the railway shares are one of the best possible forms of

<sup>1</sup> "The course of transference may be in different directions and according to its starting point and direction, it is necessary to distinguish."—Bastable, *Public Finance*, p. 372.

<sup>2</sup> It is needless to say that for most of this terminology and distinction, we are deeply indebted to Seligman. *Vide his Shifting and Incidence of Taxation*, pp. I-15.

investment. If the government levies an annual tax of 1 per cent on the nominal value of these shares, the net rate of interest now yielded will be reduced to 4 per cent. Assuming that railway shares are a very small part of the total shares, the rates of interest of other comparable securities will remain intact at 5 per cent, so that the balance of advantages is now against investment in railways. Those who are already owning the railway shares have no option, and must reconcile themselves to the lower yield. But not so for new investors. They will go in for other shares and bonds, until the railway shares yield an equal rate of interest. This can only happen through a reduction in the price of railway shares by an amount, the interest on which will be equal to the amount of the tax; i.e. Rs. 20. The price of the railway shares must, therefore, come down to Rs. 80. The tax will thus be capitalized. Those, who purchase railway shares after the tax is imposed, will bear no share of it,<sup>1</sup> because at the time of their purchase they have already discounted the future payments of taxes. Those, who own the shares at the time of the tax imposition, will be gravely hurt, for they will have to pay the tax not only as long as they hold the shares but also the tax payments thereafter. Imposition of such a tax amounts to a partial confiscation. Once the injustice is done, no redress is possible. Suppose that in the above mentioned case, the government, realizing after two years that grievous injustice has been done, decide to abolish the tax. During this period, many of the railway shares will have changed hands, many old owners will have lost Rs. 20 per share; all the new owners will have already discounted the tax. When the tax is removed, by a process reverse to that described previously, the price of the shares will once more rise to Rs. 100. But the old owners, who have sold out their shares, will receive no compensation for the wrong done to them. The existing owners will be benefited to

<sup>1</sup> The saying "old tax is no tax" derives its validity from this phenomenon. This has been described in the case of land tax in France as the doctrine of immutability.—Seligman, *Shifting and Incidence of Taxation*, p. 177.

the extent of Rs. 20 per share. Many of them are likely to have obtained their shares at Rs. 80, and their gain will be undeserved. Only in the case of those few, who have stuck to their shares, justice will be done. The greater the time for which the tax has remained in force, the less will be the number of such old shareowners among the present shareholders, and therefore the less the prospect of redressing the past wrong.

### Conditions for Capitalization

Since the imposition of the tax likely to be capitalized is a grievous wrong admitting of no redress afterwards, and since we now no longer think of capitalization as a phenomenon peculiar to land, it is essential to consider, in detail, the circumstances under which a tax is likely to be capitalized. From a careful study of the process, the following conditions<sup>1</sup> emerge as essential.

(i) The commodity taxed must be durable. If the taxed article is such as perishes in the act of consumption, or lasts only for a short time, there is no possibility of a series of tax payments, and without them there is nothing to capitalize. A tax on bread or wheat cannot be capitalized.

(ii) The tax levied must be of a fairly long duration. The first instalment is usually paid by the present owner, and if some more tax instalments are not expected, there can be no discount for them in the purchase price, and no capitalization. It must be remembered that expectations play a very important role here, sometimes as great as actualities. If a tax has been, in the first instance, imposed only for one year, but bids fair to continue for a long period, it is almost as likely to be capitalized as one avowedly for a long duration. On the other hand, a tax law of an unlimited duration may have the contrary effect if it is anticipated that the tax will be discontinued in a short period.

(iii) The item taxed must be of such a character that it has a capital value negotiated through market purchase

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<sup>1</sup> A large part of this section is based on Seligman, pp. 174-183 and pp. 221-226.

and sale. If the commodity affected has no capital value, there is nothing which can depreciate. A tax on wages cannot be capitalized in our society, for a labourer has no market value. But in a slave society, where men are bought and sold, their value will be arrived at through the capitalization of their earning power, so that a tax on the earning power will lower the value of slaves and hit the existing slaveowners hard.

(iv) The tax levied must be partial or exclusive. In case, where the tax is general, other alternatives of capital investment become equally odious, so that no better choice is available for the investor. If, in the case we have assumed before, along with the tax on railway shares, a similar tax were levied on other forms of investment, the investors will find no possibility of earning more than an interest of 4 per cent (provided they insist on the same security and marketability). The price of railway shares will remain the same, and there will be no capitalization.

(v) If the nature of the commodity taxed is such, that there is a prospect of shifting the tax forward, there is no likelihood of capitalization. Suppose, for instance, a tax is levied on raw cotton, and it is possible for the grower to pass the tax onwards to the manufacturer, merchant, etc. Then, the yield of the cotton-growing land will remain as before, so that no depreciation in capital value will follow. In case of taxes on capital invested in spheres where an expansion of activities is essential, a shifting onwards is usually possible. No capitalization will follow in such cases.<sup>1</sup>

(vi) Unless the article taxed is such, that there is a rapid change in its ownership—rapid both absolutely and rapid in relation to the period of time the tax is expected to last—the tax will not be capitalized, for in such cases, as Rau points out,<sup>2</sup> the original owners or their heirs will retain their possession, and there will be no chance for the diminution in capital value through purchase and sale.

<sup>1</sup> Stamp, p. 133.

<sup>2</sup> *Vide* Seligman—*Shifting and Incidence of Taxation*, pp. 181-182.

It must be remembered that the mere fact that a tax is capitalized is no guarantee that it will be felt burdenless by future purchasers. The value of the item taxed may so vary due to reasons other than the tax imposition that the new purchasers are as tax-conscious as if no capitalization had occurred.<sup>1</sup> Where the yield is by its inherent nature fluctuating, the tax consciousness is likely to be strong.<sup>2</sup>

### Transformation

Both shifting and capitalization require favourable conditions, which are sometimes not present. It is, therefore, not always possible to escape the tax through these methods.<sup>3</sup> Moreover, unless the demand for a commodity is perfectly inelastic, the shifting of the tax means a shrinkage in sales, and possibly a reduction in profits. Thus, even a success in shifting may prove costly. The merchant or the manufacturer is, therefore, in a quandary, and has to think hard. This will lead him to scratch his head violently, and he may, at times, hit at some device or improvement in the process of production, whereby the costs of production of the taxed commodity are decreased. With this improvement he can afford to sell at the former price without any reduction in his profits, or he may even be able to increase them. Since the loss of taxation is, by the alchemy of improvement, turned into a gain, the process is known as one of transformation.

Such a happy combination of circumstances, where both the State and the traders or the manufacturers are richer because of the tax, and the consumers at least not worse off, is rare, and can certainly be never predicted in advance. It is entirely unwarranted to make a claim on the basis of this, as some have done, that a tax on industry is likely to prove a spur to, rather than a drag on, enterprise, and that a tax on necessities is likely to be of more

1 Cf. "A capitalized tax is burdenless to the purchaser only so long as the conditions assumed in his capitalizing calculations do not turn against him."—Lutz, *Public Finance*, p. 380.

2 Seligman, p. 270.

3 Cf. "The desire to pass on the burden may be universal, but the capacity to do so is limited."—Bastable, *Public Finance*, p. 372.

benefit than harm to the nation through its effect on labourers.<sup>1</sup> Nonetheless, the happy combination does occur at times. It certainly dare not be gainsaid that the imposition of a tax compels the traders and manufacturers to explore all the possibilities of reducing their costs, and sometimes the search yields valuable results. It is true that under competitive conditions the desire for greater profits and even the anxiety to survive furnish powerful incentives to the producer and the trader to improve their methods. But lethargy and unwillingness to take unnecessary risks may at times prove more powerful. The imposition of a tax will destroy this inertia. Fear is a greater psychological stimulus than hope, and under its stress the timid are known to become brave and the idle industrious. The prospect of a reduction in profits may make the producer hazard on experiments, which the lure of higher profits could never have induced him to embark upon.<sup>2</sup> The consequences of the tax on whisky in Scotland in the eighteenth century, and of that on beet sugar on the continent in the last century are instances of this.

On whom should the tax burden be regarded as falling, in the above case? Seligman thinks that in such a case, the incidence should be regarded as falling on the producer or the trader.<sup>3</sup> Unless it were so, he would have no incentive to transform his loss into a possible gain, and no process of transformation could take place.<sup>4</sup> It is difficult for us to agree with this view. The improvement in the process of production would have come in any case, and the prices

1 For opinions of several authors of this type, see Seligman, pp. 47-55.

2 Cf. "Man is not influenced solely by hope, he is powerfully operated on by fear. Taxation brings the later principle into the field, and to the desire of rising in the world implanted in the breast of every individual the increase of taxation superadds the fear of being cast down to a lower station, of being deprived of conveniences and gratifications which habit has rendered all but indispensable; and the combined influence of the two principles produces results that could not be produced by the unassisted agency of either." —McCulloch, *Taxation and the Funding System*, quoted in Adams, pp. 401-402.

3 "In the case of transformation....the incidence is on the original tax-payer." —Seligman, p. 7.

4 "If there is no incidence, there can be no transformation." p. 7. Seligman here forgets that it may be the effects as well as the incidence that might prove a spur.

of the commodity in question would have been reduced. The tax is at best only the occasion, not the cause, of the betterment in production.<sup>1</sup> The tax prevents the benefit of the improvements, which it only quickened, from passing on to the consumers, and therefore must be regarded as being borne by the consumers, not by the producer or the manufacturer.<sup>2</sup> However as transformation is admittedly an unusual happening,<sup>3</sup> this question is of little practical moment.

## II. Incidence and Effects

### Colwyn Committee

Before embarking on any discussion as to the method of finding out and measuring incidence, it is essential to distinguish clearly the incidence from the effects of a tax. The lack of a clear difference has often led to great confusion. Unfortunately, no clear-cut distinction is available. For the earlier writers, the difference did not exist; they used both the words as synonyms.<sup>4</sup> The later writers, however, have attempted to give two distinct and different connotations to them. The best known distinction is that drawn by the Colwyn Committee. According to them, the term incidence is used by the economists to denote the more immediate burden of the tax as distinguished from its further effects.<sup>5</sup> To illustrate this difference, they cite four

1 This is grudgingly conceded by Seligman. "It may be that the improvements would probably have come about of themselves after a time; but this does not invalidate the accuracy of the contention that a tax may be the occasion, even if it be not the cause, of a betterment in production". *Ibid.*, p. 6.

2 In a very parallel case, where in a seller's market, an income-tax offers greater inducement to traders to put up their prices, Seligman holds the tax to be on sellers, not on the buyers, for the prices would have gone up in any case.—Appendices to the Report of the Committee on National Debt and Taxation, p. 123.

3 "Shifting is the most common, capitalization somewhat less usual, transformation rather infrequent"—Seligman, p. 8.

4 See, for instance, the opening of Edgeworth's famous article on Urban Rates. "Incidence here denotes all those effects of taxation with which the economist is concerned."—Vol. II, p. 151; also Marshall's Principles (7th Edition), pp. 413-415 and App. G.

5 "In general usage, the term (incidence) covers not only the initial burden of a tax, but the whole range of consequential effects. Economists, however, have given it a narrower meaning. For them "incidence" is only concerned with the question on whom the more immediate burden of the tax as a tax rests. It is to be distinguished from the question of further effects, which may be exceedingly important."—Para 288.

cases—the first of an employer, who as a result of a tax on him cuts down his staff; the second of an employee, who, as a result of a tax on him, fights for and succeeds in obtaining an increase in wages; the third of a trader, whose sales are reduced because of his shifting the tax on to customers; and the fourth of a trader, who, as a result of the taxes he has to bear, works the harder. In the first, second, and fourth cases, they regard the tax incidence as falling on the taxpayer, though the tax may have serious effects on others. In the third case, though there may be loss on the balance, the tax has been shifted to the consumers.<sup>1</sup>

Though all the instances except the second,<sup>2</sup> which the Committee have cited, will command universal approval, their definition of the terms is by no means illuminating, and is not in accordance with the examples given by them. The distinction between incidence and effects, as visualized by them, seems to centre round the time lapse. The short-period consequences of a tax are expressed by the term "incidence," the long-period results by "effects."<sup>3</sup> But the illustrations given do not lend any countenance to this belief. In instance one, it may be that the taxed employer, reduces his staff, immediately the tax is announced, to compensate for his loss because of the tax. Yet, the committee would hold that this is an effect of taxation, not its incidence. In case of commodities of inelastic supply, the traders will wait for a long time before raising the prices, and yet from the moment of price rise the incidence of the tax must be said to lie on the consumers. The period distinction, therefore, fails to provide a difference, which will fit in with the widely held views regarding the tax consequences that can be termed "incidence" and those that can be called "effects."

1 *Ibid.*, paras 288 and 290.

2 Seligman rightly held that in the second case, the incidence is on the employer—See his 'Shifting and Incidence of Taxation,' pp. 367-370. The Committee themselves do not seem to be very sure about this point, for only two pages afterwards, they discuss again the question of incidence of a tax on salaries, and admit the possibility of shifting it on to employers. Paras 296-298.

3 Black—*The Incidence of Income Taxes*, p. 31.

### Black's Interpretation

An attempt has been made by Mr. Blaek to so define the word "incidence" so as to bring it in line with the instances given by the Committee. He makes the whole difference hinge round the assumption regarding the factorial supplies. When these are taken to be fixed, the consequential result according to him is called "Incidence;" when they are treated as variables, the result is referred to as "Effects."<sup>1</sup>

This distinction, though avowedly meant to clear up the difference that lay at the back of the Committee's mind, does not suit with their illustrations. All the instances given by the Committee do not turn on the assumptions regarding the fixity or the fluidity of the factorial supply. In illustrations second and third, for example, the change in the factorial supply is not at all in question. The cases of "incidence" and "effects" agreed upon by other writers are even less satisfied by this definition. Sometimes, to recover the interest he has to pay on the additional outlay due to the tax, or because of the currency unit being such as not to admit of a price addition of the precise amount of the tax, the trader raises the price of the commodity by an amount greater than that of the tax. Most of the writers on public finance agree in regarding this extra rise as not the incidence, but the effect, of the tax.<sup>2</sup> Black's definition does not allow for this distinction.

### Seligman and Others

Seligman, who has done so much to clear up the terminology regarding taxation, and has considerably enriched it, is not very explicit on this point. He speaks of the pressure of taxation as denoting all incidental burdens different from incidence,<sup>3</sup> which is defined as the settlement of the burden on the ultimate taxpayer.<sup>4</sup> It is made clear that

<sup>1</sup> *Ibid.*, p. 33.

<sup>2</sup> Seligman—*Shifting and Incidence of Taxation*, pp. 11-12.

<sup>3</sup> "These incidental burdens may be summed up under the head of pressure of taxation"—*Ibid.*, p. 11.

<sup>4</sup> "The settlement of the burden on the ultimate taxpayer is called the incidence of the tax".—*Ibid.*, p. 1. Also "The incidence of a tax marks the final payment by the bearer". *Ibid.*, p. 11.

the pressure of the tax includes not only the pressure of incidence, but also that of impact and of evasion.<sup>1</sup> To denote all these, the word "effects" in its wider sense is used.<sup>2</sup>

All this, while certainly very informative and instructive in other respects, does little to clear up the confusion, created by the lack of a clear difference between "incidence" and "effects." Fortunately however, he gives a number of illustrations to show the difference, and his footnotes are richly suggestive of the distinction he would have made out if forced to do so. He would, it seems, agree with Dalton in confining the term "incidence" to "the direct money burden of the tax"<sup>3</sup>—the word "direct" to bring out its distinctness from other indirect burdens, the term "money burden" to show its contrast with real burden. To grasp clearly the full significance of the definition, it must be realized that there is no specific burden without a corresponding revenue to the government,<sup>4</sup> and no pie of revenue without a corresponding burden on the taxpayers.<sup>5</sup> The total direct money burden is, therefore, equal to the total tax revenues of the Government, and *vice versa*. This concept of "incidence" makes it a perfect instrument for measuring how much each subject or class of subjects contributes directly in money to the State Treasury. It fits in with most of the illustrations given above. It also solves satisfactorily a number of questions that arise in the measurement of the tax burden, e.g. the problem of differential duties on the same commodity.<sup>6</sup> In all our further discussions, therefore, we wish to stick to this concept, though it may at times mean conflict with high authorities.

1 *Ibid.*, pp. 11-13.

2 "In the wider sense effect denotes any of the subsequent results of taxation."—*Ibid.*, p. 14.

3 "More precisely we may say that the incidence is upon those who bear the direct money burden of the tax."—Dalton, p. 51.

4 "As Natoli well points out there can be no incidence without a corresponding revenue to the treasury."—Seligman, p. 12. Seligman himself seems to agree wholeheartedly with the view.

5 "To every shilling of revenue raised, there corresponds a shilling of direct money burden, or incidence falling upon someone."—Dalton, p. 51.

6 The question will be more fully discussed in Chapter IX.

### III. Value of the Study of Incidence

#### Narrow Scope of the Study

(a) **Exclusion of the Effects of the Tax System:** The word "incidence" so defined may seem to some too narrow a concept to be worth any serious study. Those who escape the tax in a legitimate way may often suffer much more than those who pay it. Everytime there is a tax on a commodity, and it is borne by the consumers, (whether it be levied first on the manufacturers and sellers and then shifted to them, or whether the tax is levied directly on the consumers and cannot be shifted backwards by them) there are some of them who will reduce their purchases and thus escape a part of the tax, and a few will prefer going absolutely without the commodity. On this abandoned part of the consumption no tax is paid, and therefore there is no incidence. Yet, the deprivation suffered is frequently greater than that of those, who continue to make their purchases and on whom, therefore, the incidence is said to lie.<sup>1</sup> What Seligman calls the pressure of evasion is usually more, severe than the incidence of the tax; and this pressure lies outside the scope of the study of incidence.<sup>1</sup>

A more important omission is of those vastly important effects which led us to introduce great changes in the "minimum sacrifice" principle in the last chapter. The great transformations for good or for bad that the tax system brings about, its effects on quality and quantity of savings and on labour supply and its consequences on the spirit of enterprise and the willingness to take risks are vastly important. They make or mar a nation's fate.<sup>2</sup> A neglect

1 "Persons, who pay a tax, are often less injured by its imposition than those who pay no portion of it. The man who goes two miles out of his way daily to avoid a bridge toll would be far more benefited by the freeing of the bridge than most of us who pay the toll."—Cannan in *Memoranda chiefly relating to the Classification and Incidence of Imperial and Local Taxation*, submitted to the Royal Commission on Taxation (1899), p. 166.

2 Cf. "A tax may have great many effects. It may diminish industry and impoverish individuals; it may stimulate production and enrich individuals; it may be an unmitigated curse to society, it may be a necessary evil; it may be an unqualified boon to the community regarded as a whole."—Seligman, p. 14.

of these considerations may well prove fatal. And yet, incidence takes no account of these.

(b) **Exclusion of the Effects of Expenditure:** We speak usually of a tax as a burden<sup>1</sup> as if the tax proceeds were given as a tribute by the community to the government. In so doing we lose sight of the fact that these proceeds again return to the community in the form of State services. This habit of thinking is a legacy from those times, when that government was looked upon as best, which governed least. | But with the expansion in government activities, with the rise in expenditure that this implies, and with the increasing care that economists bestow on their studies, the fact that the expenditure of the State has effects as important as the raising of the revenue is being increasingly realized.<sup>2</sup> | The effects of government spending, it is now recognized, are entitled to as much attention as those of its methods of raising money. A theory of public finance neglects this study at its own peril. But in considering the incidence of taxation, no account can be taken of this side, except when some revenue has been earmarked for expenditure on the same source, from which the revenue has been raised.<sup>3</sup>

### Justification for the Study

Due to these limitations, the study of "incidence" has appeared futile to some who have pleaded for the entire

1 Adams rightly says: "Taxes are frequently spoken of as burdens, and there is no objection to such a use of language, provided the phrase is employed in the same sense as when speaking of any of the necessary items of expenditure in the domestic budget. If the payment of a coal bill or a quarter's rent be a burden, then is the payment of a tax burden."—P. 323.

2 E. G. though the Colwyn Committee were concerned, by their terms of reference, with no expenditure other than that on the national debt, they devoted more than nine pages to a discussion of the expenditure as a whole, for "it would be impossible to form any just estimate of the effects of existing taxes without giving some attention to other objects of government expenditure."—Report, para 256. They again and again refer to the expenditure side when discussing the effects of particular taxes. The greatest emphasiser of the importance of expenditure side is the Italian Antonio De Viti de Marco—First Principles of Public Finance, pp. 148-160.

3 See Kendrick's earlier article on "Public Expenditure; a neglected consideration in Tax Incidence Theory", The American Review, (1930) pp. 226-230, and his fuller exposition in his "Taxation Issues", Chap. V.

dropping of that word. The most vigorous plea has come from Cannan. "I have no doubt," he says, "that it is desirable to eschew the use of the term 'incidence' of taxation. It unduly restricts inquiries into the justice and expediency of taxes, since it is always held that the 'real incidence' of a tax is upon the persons who ultimately pay or provide the money for the tax. . . ! It is therefore far better to consider the effects of taxation. By using this more general term, we shall find it easier to avoid the usual mistake of supposing that taxes are subject to economics of their own, instead of having effects just like any other expense. We shall also be less likely to lose our way by attempting to travel by short cuts."<sup>1</sup>

The criticism would have been entirely true if wild claims and hopes were entertained for the study of incidence. No such undue sense of its importance seems to have actuated the efforts of the great writers on "incidence." They fully realized the limited value of the study of incidence, and also of the far more important and valuable consequences implied in the term "effects."<sup>2</sup> But the term "effects" may denote a wide variety of things,<sup>3</sup> and it was impossible to study such a vast phenomenon without a further subdivision and classification. All real advancement in knowledge has been based on division and specialization, though these have meant the narrowing of the subject-matter of each individual's study. Of however limited value his own study, the student can console himself that this is the best way to advance human knowledge.<sup>4</sup> The real question, therefore, in considering whether "incidence" should be separately considered is not how limited its scope is, but whether its study further advances the wider study

<sup>1</sup> Cannan, p. 160.

<sup>2</sup> Seligman, p. 14; the Colwyn Committee devote more pages to effects than to incidence.

<sup>3</sup> "Effect includes anything."—J. Row-Fego quoted in Seligman, p. 13.

<sup>4</sup> "The few crumbs that science can offer are more nourishing than the no-bread of speculation, which....defies the lightning."—George A. Dorsey, quoted in the Report of the New York State Commission for the Revision of the Tax Laws, p. 100.

of effects.<sup>1</sup> Thus put, few, we think, will gainsay the necessity of studying the incidence of a tax, for it forms an important and indispensable preliminary to the study of its effects. The latter, without the former, will be abortive due to its very vastness and comprehensiveness.

#### IV Incidence—A Study in Prices

We have seen so far three methods of escape, through which the taxpayer bears no tax burden—evasion (legal and illegal), shifting, and capitalization.<sup>2</sup> The first yields no revenue to the treasury, and is therefore of no importance in the study of incidence. Both shifting and capitalization can only take place through the process of prices, so that a study of incidence becomes a chapter in the theory of prices.<sup>2</sup> Since prices are in normal times seldom governed by law or custom a tax can bring about a change in the price of the commodity affected only through a change in its demand or supply. The demand curve is assumed to remain constant, since in a study of incidence we exclude the changes brought about by the expenditure of tax proceeds. It is, therefore, only through a change in the supply of the commodity that the tax can be shifted. In discussing the question of incidence, we need watch the effects of the tax only on the supply of the taxed commodity.

##### Price Changes and Incidence

We have said above that shifting can only take place through the price medium; but the converse is not true. The effort to trace shifting through prices is often misleading, because as we have seen earlier, not all price changes, even when they are due to taxation, are included in "incidence."<sup>1</sup> Some of them are rather the pressure of impact

<sup>1</sup> The importance of the study of incidence has always been put forward as furthering the study of effects. "They (the effects) can, however, not be successfully attacked unless we previously solve only the question of shifting and incidence."—Seligman, p. 14. "It is only when we have ascertained the incidence that we can proceed to discuss the wider effects of a tax."—*Ibid.*, p. 14. Also "this is the first thing to be decided about any tax."—Colwyn Committee Report, para 288.

<sup>2</sup> Cf. "The theory of the shifting of taxation is a part of the wider theory of value."—Seligman, p. 219.

or incidence.<sup>1</sup> [It is only those price changes, the benefits of which accrue to the Government coffers, that are included in incidence.]<sup>2</sup>

Changes in prices are due to many other factors besides taxation. The course of the trade cycle, changes in public taste, changes in natural factors—all these rapidly-changing events usually so affect prices, that it is well-nigh impossible to trace the effect of taxes on prices. [It has often happened in history that the price of a commodity has risen after the reduction or abolition of a tax, and it has fallen after the imposition of, or the increase in, a tax.] The price of bread rose slightly in the few years following the repeal of the Corn Laws.<sup>3</sup> Such striking contradictions ought immediately to put us on the guard, and they do so after a time. But when the change in prices due to other factors is not in the opposite direction, but only means an intensification or slackening of the change that would have otherwise come about, a confusion is likely to ensue. One has, therefore, to wade through the difficult mass of incidence problems without any valuable help from price statistics, relying chiefly on the deductive method.

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1 We have already seen some of these cases. A similar case arises when the commodity taxed obeys the law of decreasing costs. Here, the diminution in production brought about by taxation will mean a rise in production costs, so that the price rise will be greater than the rate of the tax. Seligman, however, disagrees on this point. *Vide* Chap. VII.

2 Bastable, however, differs. "It seems more in accordance with language and principle to treat the loss incurred by the citizen as coming under the head of incidence even though the State does not obtain revenue. The burden of many taxes is greater than their yield, but it is hardly admissible to cut up this burden into two parts, one measured by State receipts, belonging to the topic of incidence, while the balance is treated as the 'effect' of taxation."—*Public Finance*, p. 361.

3 Silverman—*Taxation, Its Incidence and Effects*, p. 93.

## CHAPTER III

### INCOME TAXES

#### A General Income Tax

##### I. Incidence of Income Tax

In our discussions in the first chapter, we have seen the great refinements that a regard for justice would lead us to introduce in our tax system. The income tax is, in many respects, best fitted to satisfy these. It is now generally agreed, that income is the best single criterion of measuring the sacrifice caused to a person by the deprivation of a certain amount of his money. An income tax is related directly to income, and can, therefore, easily be so adjusted as to impose the desired sacrifices on various income-classes. Many other complex considerations which are relevant in determining the sacrifice imposed, e.g., the greater needs of the family men and of persons with earned incomes, can be taken into account in the imposition of this tax.

None of these advantages, however, can be realized, unless the incidence of the tax is upon the taxpayer himself.<sup>1</sup> Unfortunately, we have no unanimity regarding the persons who bear it.<sup>2</sup> The witnesses before the Colwyn Committee were sharply divided on this point. One side, consisting mostly of businessmen,<sup>3</sup> contended that income tax was a part of the cost of production, and was, therefore, shifted like other costs of production to the final consumers. The

1 "If and so far the latter view (the view that Income Tax can be shifted) is correct, the Income Tax must abandon part of its chief claim to virtue as a method of taxation"—Report of the Committee on National Debt and Taxation, para 293.

2 See Appendices to the Report, p. 65.

3 The businessmen, naturally, were not very logical in their arguments. But the best view was that put forward by Mr. Leake. "Apart from current price fluctuations due to changes in supply and demand, the general level of selling prices must inevitably be based upon the cost borne by employers incidental to production, and this cost includes the employers' disproportionate burden of progressive taxation"—Report, para 294.

other side, containing almost all of the economists, argued that the tax, with slight and unimportant exceptions, rested where it was placed. The controversy was decided by the Committee in favour of the economists.) However, the arguments put forth by those two, who most thoroughly and elaborately developed the economists' viewpoint, were not very happy, and were at great variance with each other, so, that the controversy was soon revived.

The best way to deal with this problem is to divide income into its constituent forms<sup>1</sup> —rent, wages, interest and profits, and to see how a tax on each will affect its supply.

### Tax on Rent

It is obvious that a tax on pure rent cannot be shifted. Economic rent is the result, not the cause, of high prices. Prices are determined by the marginal land, which pays no rent, so that "a tax on rent would affect rent only; it would fall wholly on landlords, and could not be shifted to any class of consumers."<sup>2</sup> With this view of Ricardo, most modern economists agree, so that it is no use labouring this point.<sup>3</sup>

### Tax on Wages<sup>4</sup>

In discussing the incidence of a tax on wages, it is convenient to divide labour into two broad divisions: skilled and unskilled. It has usually been held that a tax on the earnings of the unskilled workers will be shifted to employers. This view, however, is not true. The supply of unskilled labour is not elastic in the short run, and even its elasticity in the long run is doubtful. Only labour organization and the growth of social consciousness asserting

1 "In such cases (where income tax is a combination of taxes on the separate ingredients of income) there can be no question that each part of the income-tax follows the law of incidence of the respective separate taxes"—Seligman, *Shifting and Incidence of Taxation*, p. 386.

2 Ricardo, *The Principles of Political Economy and Taxation*, 2nd edition, p. 201.

3 For further discussions, see Chap. VI.

4 At one place, as we have seen, the Colwyn Committee thought that the passing on of the burden to the employer by the wage earners belonged to the study of effects rather than of incidence.

itself through the State have kept up wages to the subsistence level in some industries. A tax on wages, even when they are obeying the iron law, may therefore rest on the workers. Usually, the normal average wages of to-day cover, besides subsistence cost, also the cost of conventional necessaries. There are, therefore, greater chances of the tax being not shifted. The workers certainly will cling to what they think their birthright, the right of living in the old way, with all the tenacity they can command, and will fight with all the weapons in their armoury to maintain their customary standard. But that is no guarantee, even where the trade unions are strong, that this standard will not be reduced. Much depends on the relative strength of the two parties—the employers and the labourers—and the attitude of the State and the people. But where the necessity is compelling and lasts long enough as during a depression, the reduction is inevitable. A tax, therefore, on wages, when they are more than subsistence allowances, will or will not be shifted according to the resistance power of the bargaining parties, the ideas that have come to rule the relations between labour and capital, and above both, by the general course of the trade cycle. This question, however, is of little practical moment, as on administrative grounds a direct tax on the wages of unskilled labour is generally avoided.

The problem of the incidence of a tax on wages of skilled labour is of greater practical importance, as an income tax on skilled labour is found in some countries. Such a tax is more likely to rest on the labourers only.<sup>1</sup> Though we often speak of the cost of production of skilled labourers,<sup>1</sup> their supply is more regulated by available educational facilities, the social prestige they command, and other such factors than by the hope of an emolument. A reduction in their monetary rewards can hardly affect their supply. The present overcrowding of some professions in spite of their meagre average reward because of the social esteem they

<sup>1</sup> "It is only by a perversion of words and of facts that we can consider the time and efforts spent in educating a member of a profession as a capital which must earn interest."—Seligman, p. 368.

command proves this inelasticity. Skilled and unskilled labourers today are non-competing groups; so that a tax on one, even when the other is not taxed, will not lead to shifting. As the tax is at an equal rate on the incomes of all skilled labourers, there is no possibility of the taxpayer giving up his present occupation except in those rare cases, where the non-monetary advantages of another occupation prove a deciding factor.<sup>1</sup> A tax on skilled labour will, therefore, stick to the taxpayer with only one important exception. Where a professional man is charging less than what he can get out of a humanitarian motive or otherwise, the imposition of a tax on him may make him reconsider his position and charge higher fees.<sup>2</sup> But here though the tax acts as the motive, as Siverman<sup>3</sup> points out, inducements from other quarters like household extravagance or a pressing creditor would be equally effective, so that it is wrong to say that the income-tax has been shifted in this case.<sup>4</sup>

Whereas the economic forces will not work to shift the tax on wages to the employer, it may be that in certain cases a convention has grown up, whereby the employer undertakes to pay the income-tax on behalf of his employees. Here, it may be feared, that the income-tax leads to higher salaries in fact. Usually, however, the rise in salaries is illusory. It is quite likely that in accepting the post the employee has also considered this advantage, and that but for this concession he would have found other avenues of employment more attractive. The employer, on his side, may have taken into account this additional facility in fixing up the salaries attached to the posts. Until, therefore, the income-tax rate increases more than antici-

1 For a fuller discussion, see Black—*The Incidence of Income Tax*, pp. 9-10.

2 This possibility also exists in case of rent and profits, where due to ignorance, inertia or otherwise, the landlords or the traders are not charging the full amount they can get. In professions, however, the possibility is more because of the greater strength of non-monetary forces.

3 *Taxation, Its Incidence and Effects*, pp. 146-147.

4 Surprisingly enough, the Colwyn Committee hold the same view though in the case of "transformation" process, they seem to agree with Seligman in holding that the incidence is on the seller.—Report, para 312 and para 290 (c).

pated, the payment of the employees' tax by the employer is apparent only. Even when such a thing happens, the rise in salaries cannot be reflected in higher prices, unless the other competing firms in the same business follow an identical course. And, this is very unlikely.<sup>1</sup>

### Tax on Interest

We have seen that of all the factors of production, capital has the most elastic supply. Here, at least, the critic may say, is the field where the tax can be shifted to borrowers and hence to consumers. The influence of a reduction in net interest rate on the quality and quantity of savings belongs, however, to the problem of effects, not of incidence.<sup>2</sup> Since interest from all fields is equally taxed no transfer is possible, and the incidence must be regarded as lying on the lender.

In real life, we have to take account of two additional factors, before we pronounce a final opinion. The State to-day is the supreme taxing authority, but economically the entire world is being knit closer.<sup>3</sup> Though all the civilized countries levy income taxes, the rates of the taxes greatly vary. This differentiation in rates may lead to a transfer of the capital from one country to another, and thus enable the lenders to pass the tax onwards.<sup>4</sup> Land cannot be moved; human beings though called fickle by philosophers will not, until compelled by great necessity, leave their country and settle into another;<sup>5</sup> but capital, being easily divorced from its owner, can be moved quickly to other countries.<sup>6</sup> A heavy tax on interest in one country may mean a great migration of capital to other countries where the tax is low. The migration will continue, until the person lending inside the country acquires a rate of interest equal to that which he would obtain elsewhere.

<sup>1</sup> *Ibid.*, para 298.

<sup>2</sup> How difficult this is may be seen from the figures of transfer abroad by British business concerns and by individuals given in the note prepared by the Board of Inland Revenue—App. XVII to the C. C. Report. Much, naturally, depends on the area of the unit concerned, the patriotism of the people, and their connections abroad.

<sup>3</sup> "The proprietor of stock is properly a citizen of the world". Smith, *Wealth of Nations*, Vol. II, (Ed. by Cannan) p. 333.

✓The difference in tax rates will be shifted on to the borrower, and onwards to the consumer; All this would be possible, but modern tax practices not only deprive any such transfer of this advantage, but even make it positively disadvantageous. (As long as a person continues to be the citizen of a State, he has to pay the tax to it on all his proceeds, whatever their sources,<sup>1</sup> except those derived from fixed property in other countries.) The State, to which the person has transferred his capital, also levies its tax on the income obtained from the capital employed in its territory. There is, thus, little possibility of a tax on interest being shifted to borrowers because of the existence of various States with varying tax practices.<sup>2</sup> /

So far, we have assumed that the tax on all factors of production is equal. It is usual, however, to distinguish in many countries between earned and unearned incomes, and to tax the latter at a higher rate. Theoretically this does not matter, as it is not possible to transfer capital into labour. But in so far as the interest on capital employed in one's own business is considered as "earned income," the starting of their own business by persons having a good deal of capital might be encouraged. However, due to the great difficulties and unlimited liability such an active business partnership will involve, the course is not likely to appeal to many.

### Tax on Profit

The incidence of the tax on profits has proved the apple of discord hitherto. In the classic battle before the Colwyn Committee as to the incidence of this tax, the most elaborate and thorough defence of the viewpoint that the incidence is on the tax-payer himself was made by Prof. Seligman and Mr. Coates. It is necessary to follow their

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<sup>1</sup> In U. S. A., the Constitution forbids this practice as among different States of the Union.

<sup>2</sup> This will not apply to foreign capital employed in a State. Unless drastic measures are taken to prevent its withdrawal, a heavy tax may lead to its flight. A part of the tax may, thus, be shifted to borrowers through a shrinkage in capital supply. Where further doses of foreign capital are essential, shifting will be quicker and more certain.

viewpoint closely to appreciate the points at issue. Prof. Seligman contended that while there was only one price of a commodity in the market, its cost of production differed greatly with producers due to differences in ability, organizing power, and luck.<sup>1</sup> The price of the commodity in normal times would equal the cost of production of the most dear unit actually sold. The marginal firm, thus, will be realizing no profits.<sup>2</sup> A tax on net profits cannot, therefore, affect it. Since the price is fixed by the marginal cost of supply, the tax on profits will not affect prices.

This line of argument concealed a great fallacy. It is certainly an oft-repeated saying that the marginal firm makes no profits. But this is only true if the word "profits" is used in a restricted sense. Profits in this statement mean the residue after all the expenses of production including the wages of management, the recompense for risk, etc., have been met. It is in this sense only that we can speak of profits as leading to expansion of production and their absence (both in a positive and negative sense) to maintaining production intact. When the word "profits" is used in its everyday meaning, the statement no longer holds true. The producer, who bears risk, and has to look after the managerial side, must get sufficient rewards if he is to continue in his business.<sup>3</sup> The income-tax laws tax not profits in the narrower sense, but in the broader sense. They tax not only "profits" but also wages of management and rewards of risk. The person owning and running the marginal "no-profits" firm has to pay a tax, and the entire superstructure of Seligman based on the opposite assumption falls to the ground.<sup>4</sup>

Mr. Coates proceeded on quite different lines.<sup>4</sup> He submitted that "the broad trend of prices is governed by the

<sup>1</sup> App. XII, p. 120.

<sup>2</sup> "Profits are the result of the industrial process; they represent not cost, but surplus over cost"—*Ibid.*, p. 120.

<sup>3</sup> Prof. Seligman partially conceded this fact at times. "The man at the margin, who makes no profit, or who makes only the minimum profits which correspond to wages of management or recompense for the risk, pays no tax because he makes no profit or pays only a negligible tax upon these minimum profits." *Ibid.*, p. 121.

<sup>4</sup> Appendix XI, pp. 68-71.

lowest or most efficient cost of production, that cost including normal profit and therefore such portion of normal profits as is taken by taxation of income." But he contended that in real life, due to the variations in human abilities and frequent changes in the consumers' needs, fancies, purchasing power and scale of preferences, the prices seldom rule so high. Producers, in their search for additional business and profits, often find themselves producing their marginal units at a loss, and the less able among them make a loss even on the whole. By an imposing array of figures based on elaborate calculations,<sup>1</sup> he showed that a material portion of the total turnover in many spheres of production was sold without any profits in U.K. The income tax would not fall on these portions, so that there could be no higher prices because of the income tax.

Mr. Coates came in for a severe man-handling at the hands of Dr. Robertson.<sup>2</sup> He pointed out that the difference between the two view-points, viz., of economic theory and of real life, could not be reduced to a "question of fact." The appeal to statistics was of little use, as when an economist, or at least Marshall, talked of the "marginal cost of production" as fixing the market price, he did not mean that the cost of the actually dearest unit put on the market determined price. The concept of the margin has essentially to be taken in conjunction with that of the "representative firm." Marginal firms, in the only relevant sense of the word, must cover their full cost, for else there can be no special relation between price and marginal cost. The firm to subsist must meet all its production costs over a long period. In the short run, prices may fluctuate round these, but they cannot remain always below the costs.

Fortunately, we need not rely on the dubious arguments of these two great champions to prove that a tax on net profits will stick where it is placed. Even as in the case of wages or interest, a simper line

<sup>1</sup> *Ibid.*, pp. 73-85.

<sup>2</sup> See his article: The Colwyn Committee, The Income Tax and the Price Level, *The Economic Journal*, 1927, pp. 568-581.

of argument is available. Even if profits are an essential condition of business, since the tax hits business equally in every direction, there is no taxless field for the tax-payer to retire to. His scale of preferences between trades remains fairly the same. Suppose, a producer obtained a profit of Rs. 100 from his production, and a tax of 25 per cent on profits is levied. His net profits will now be only Rs. 75. Since profits in other occupations would be equally taxed, he will obtain less than these profits if he changes over to them. He will, therefore, continue in his business. Since the number of producers in the industry will remain the same as before, and since the amount they produce will also be maintained at the former level, no higher prices can be charged. The incidence of the income-tax on profits will, therefore, be on the tax-payer himself.

To this broad rule, there are certain exceptions. As Seligman<sup>1</sup> points out, in a sellers' market the income tax may often be given as the reason for higher prices. This, however, is more an excuse than a cause of higher prices. It is quite likely that even in the absence of this tax, the seller would have exploited the advantage afforded by the market position to the full.<sup>2</sup> In retail luxury trades, where the fashions change quickly and where the trader has to do much guesswork to anticipate the demand, when a tax is imposed, the dealer will prefer to follow the safer course of raising prices rather than taking any hazards by maintaining old prices. The income tax that he has to pay is a certain loss to him; the reduction in sales, that may be the result of the rise in prices, is dubious.<sup>3</sup>

So far, we have confined our discussion to a tax on profits under competitive conditions. Modern life, how-

<sup>1</sup> Appendices to the Report, p. 123.

<sup>2</sup> Since a concept of "fair price" plays an important role in the determination of market price, and customers' goodwill is of value to the seller, the existence of the tax facilitates the price rise, which would have been difficult without it.

<sup>3</sup> Here, we have not considered the unimportant exception of a seller, who is charging a price below the normal competitive level. Such benevolent sellers are rare; and the advantage of their generosity does not go to final consumers, unless they happen to be the last link in the chain of distribution.

ever, presents us with a great number of monopolies and semi-monopolies. (The monopolist fixes his price in such a way as to realize the maximum net gain.) The demand curve for him, even as for competitive businessmen, is fixed; the cost of supply is also determined by factors beyond his control. But he can decide the quantity of the commodity to be produced. He may produce and supply only that quantity of the commodity, which will leave him with the greatest revenue. An income tax on net profits does not touch any of these factors, which the monopolist takes into consideration in regulating his supply. The monopolist will therefore continue with the same supply, and the same prices will rule. A net tax on profits, even in the case of the monopolist, will stick on to him.

We may, therefore, say with the Colwyn Committee,<sup>1</sup> that the conclusion of the non-shifting of the income-tax holds "over practically the whole field and practically the whole of the time, any exceptions being local or temporary and insufficient to invalidate it."

## II. Some Problems in Income Tax

Income tax, we have said, is the best weapon in the State armoury to adjust its taxation system to the requirements of justice. But this can only be, if the incomes of all taxpayers are properly assessed.<sup>2</sup> And this is, by no means, an easy task. Various injustices and inequities creep up in whatever method we may adopt. We can, only, select the least defective, and minimize the evils.

### Non-Monetary Advantages

(a) Services in Kind from Oneself or One's Family: The income tax laws usually take account of only those goods and services, which have a money counterpart. The others have to be generally ignored, so that an unintended discrimination is made between two persons of

<sup>1</sup> Report, para 321.

<sup>2</sup> Cf "A tax, whose justification lies in its accurate adjustment to personal ability to pay can only be successful, if it is actually so adjusted." Report of the Indian Taxation Enquiry Committee, para 229.

equal real incomes, one of whom has a greater non-monetary income than the other. For example, of two persons having equal real incomes, one of whom works for nine hours in the office and hires a gardener to work in his garden for one hour a day, and the other works for eight hours at office and one hour at home in his garden, the first person will be worse off under our arrangement. Of two families,<sup>1</sup> where in one the female members look after household work, and in the other they do some outside work entrusting household work to a cook and servants, the latter will have to pay more tax even if both the families have equal real incomes.<sup>2</sup> As any reform of our present laws so as to take personal services in kind into account meets with insuperable difficulties, this discrimination is bound to remain. Fortunately, the division of work has developed so much, that "one cannot go far towards making his house an autonomous society without severe penalty."<sup>3</sup> Moreover, such services are usually the same in equal income groups. The higher the income scale, the less the value of such services, so that the income tax rates are made slightly more progressive due to this defect. The omission, therefore, is not of great importance.

(b) *Services of Consumers' Capital:* But there is another failure, which is of greater significance.<sup>4</sup> The services rendered by the consumers' capital like the use of one's own house, furniture, etc., are, unlike personal services in kind, capable of a considerable expansion. The richer the person, the more the advantages he derives from these, and the greater the chances he has of evading a part of his tax in this way. Within the same income group, the benefits derived from this practice vary with the consumption habits and the occupations of the individuals. Men partaking actively in business are not able to take as much advantage of this as coupon-clippers.

<sup>1</sup> This illustration applies most to those countries, where a family is the taxable unit. In India, it is not so.

<sup>2</sup> This injustice is partly retrieved in U. K. by an extra allowance, when the wife is earning.

<sup>3</sup> Simons, p. 113.

Persons, whose occupations require a constant shifting of places, are less benefited than those wedded to a particular locality. The only attempt made to redress this inequality so far has been with regard to houses. In many countries, in computing the income of a person staying in his own house, the rent he would get if he let it to others is taken into account.<sup>1</sup> In India, residential house-property, though it yields no monetary income, is charged at the rate it would have been if rented.<sup>2</sup> Other forms of consumers' capital are not charged anywhere, presumably because the practice of hiring them has not yet sprung up. If it does, the Governments will have to take into account, as in the case of houses, the non-monetary advantages derived by the owners from using them.

**(c) Advantages Incidental to Nature of Service:** Some services have many advantages appended to them. Take, for example, a salesman employed in a high class jeweller's firm. His firm pays to him not only his salary but also reimburses him for the cost incurred in the excellent dinners and entertainments, which he stands to rich customers. It may appear at first sight that such a person should be taxed higher than other persons having the same money incomes. A little reflection, however, makes us pause. Suppose he detests those dinners and entertainments, and undergoes them only as a part of the job he is being paid for. Even if this appears unlikely, it is quite probable that left to himself, he would have preferred other things. Few servants, for example, if they did not get their livery would spend the same amount on clothes, so that the entire price of their liveries cannot be added to their nominal wages to determine their "incomes." How much of the value of the clothes should be counted as a part of their incomes is a great problem. And, as we go up in the income scales, where such "benefits" attached to the service may have even a disutility, the problem becomes insoluble. The British law decides this point very

<sup>1</sup> In U. S. A., however, this is not done.

<sup>2</sup> Indian Income-Tax Act, Sec. 9.

finely. Acting on the criterion of realization, it holds that perquisites are taxable as income only where the tax-payer is free to convert them into cash.<sup>1</sup> The Indian Income Tax Act makes all perquisites the employee gets from his employer taxable, unless they have been given by the conditions of his employment wholly, necessarily, and exclusively in the performances of his duties.<sup>1/</sup> However, as rent is a compulsory item in a family's budget, and does not vary much within the same income group, all rent-free quarters are considered as an addition to the employee's income.<sup>2</sup>

### Regular and Irregular Incomes

Hitherto, we have defined income as a flow; but much depends on whether we think it essential that the flow to be considered as income must be regular.<sup>3</sup> The general stability in Britain has led it to regard regularity as an essential characteristic of income;<sup>3</sup> capital gains and casual earnings not connected with regular business are not liable to any income tax. On the other hand, in U.S.A., where fortunes easily accumulate and as easily disappear, all these earnings, with the exception of those obtained from unilateral transactions like gifts, bequests, etc., are considered income. The Indian law follows the British practice, and specifically provides that any receipts of a casual or non-recurring nature not arising from business, profession, etc., should not be considered as income.<sup>4</sup> The advisability of the U.S.A. practice cannot be daresaid on theoretical grounds. Even irregular earnings certainly increase the individual's ability to pay. Rich persons make considerable money in this way; and the greater a person's income, the more his chances of making such profits due to his greater knowledge of the market and the advan-

1 Sec. 4 (3) (vi) and Sec. 7.

2 Sec. 7, Expt. 1.

3 The Royal Commission on the Income Tax (1920) however were in favour of regarding casual receipts as income.—Report, para 88.

4 Sec. 4 (3) (vii).

tage of his riches.<sup>1</sup> To ignore, therefore, capital and casual gains is to render the income tax rates much less progressive than they seem in the higher ranges of income. Of course, the provision for taxing such gains will also necessitate a parallel provision for losses; and it may be, as is often argued, that the State gains little in the bargain. Our criterion, however, being justice, and not productivity, this apology for the British practice cannot satisfy us.<sup>2</sup>

### The Time Element in Income

It is absolutely imperative that income should be defined as the flow within a certain period. Usually one thinks—or rather the income tax payers think—in terms of a year. But there is no sanctity about this period.<sup>3</sup> Its fixation is more a matter of administrative convenience than of any principle. Nonetheless, it gives rise to many troublesome questions, the most important being due to the fluctuating character of incomes in certain businesses. If businessmen are asked to pay taxes every year on the basis of the profits of their previous year, a businessman with an irregular income may suffer as against one with fixed income,<sup>4</sup> especially when the income tax rates are progressive, and the level of exemption is fairly high. Suppose, for example, that the rates are 2 annas for all incomes between Rs. 10,000-Rs. 50,000 and 4 annas for profits above Rs. 50,000, and the level of exemption is fixed at Rs. 10,000. Take two firms, one of them engaged in a trade yielding a fixed income of Rs. 40,000 a year, and another

1 In U.S.A., for the year 1929, those with incomes between \$150,000-\$1,000,000 derived 40 per cent of their total income from capital gains; persons with incomes above \$1,000,000 derived about  $\frac{1}{2}$  of their income in this way. About 90 per cent of this capital gain is derived from sales of stocks and bonds.—Green, pp. 122 and 124.

2 The unfairness of taxing a capital gain accruing over a number of years as if it were an income received during one year can be removed by a practice on the U. S. A. lines of regarding such a gain as amounting to a particular fraction of the regular income, the exact fraction varying with the number of years the property had been held.

3 The labourer thinks of the week as the right unit, the salary earner of the month.

4 It must be admitted as against this that in some cases risky businesses may also be at an advantage, but such cases are less frequent.

engaged in a risky trade, and faring very unevenly in different years, its profits being in a cycle of three years Rs. 60,000, Rs. 40,000 and Rs. 20,000 respectively. In the only sense of the word "income" that matters, both of them have equal incomes. Yet, under our income tax system, the first firm will be asked to pay an income tax of Rs. 15,000 in three years, the second will have to pay Rs. 22,500. This is very unfair to those engaged in risky industries. To remove this defect, various expedients have been suggested, and resorted to. U.K., for example, had adopted for some years the three-year average system. This, however, has other adverse effects; it hits a taxpayer hard, when his income is falling and *vice versa*.<sup>1</sup> Another way to remedy this is to make a provision whereby the loss incurred in one year can be offset against gains made in subsequent years. In Great Britain, business losses can be carried forward for six subsequent years against business gains. It is essential to remember that whereas this system does provide relief in cases where the business makes a loss one year and a gain another year, where the fluctuations are confined to profits only and there are no losses (the case we have considered just before) the situation remains as bad.

In India in spite of the recommendations of a Committee,<sup>2</sup> upto 1939 there was no provision for any sort of relief, whereby losses could be carried forward and set off against future gains. But from the year of assessment ending 31-3-1940, a provision has been made for setting off previous losses against gains from the same business, pro-

1 Take, for example, a person who has an income for six years of Rs. 40,000, Rs. 80,000, Rs. 30,000.—Rs. 50,000, Rs. 40,000 and Rs. 1,00,000 respectively, and let the tax be a proportional one at the rate of 2 annas in a rupee. In the fourth year, on the three-year average system, he will have to pay a tax on Rs. 50,000, i.e., Rs. 6,250 as income tax. In the fifth year, he will have to pay a tax on Rs. 20,000, i.e., Rs. 2,500, though actually he has made a loss in the preceding year. In the seventh year, he will have to pay only on Rs. 30,000 though he has actually made a profit of 1 lakh in the preceding year.

2 "It seems to them that the substantial justice of the claim to be permitted to set-off cannot be denied."—Report of the Indian Taxation Enquiry Committee, para 230.

fession or vocation in future years. / The maximum time for which losses can be carried forward is six years. /

### Tax-Exempt Securities

So far, we have seen cases, where there was room for difference of opinion among experts, and where the governments' policy, however mistaken, could be *bona fide*. In tax-exempt securities, we have a case where the governments flout the considered unanimous opinion of economists and must therefore shoulder the whole blame upon themselves. The floating of such securities gives a temporary advantage to the government, and it may be argued as in the case of U.S.A. securities that any possible loss in future revenue is more than compensated for by the favourable terms on which such loans can be floated.<sup>1</sup> This is possible, but the greater productivity of such loans cannot hide their hideous injustice. Generally in the premia put on these loans, only the prevalent income tax rates could have been taken into account. Any rise in rates after this period is an underserved advantage to the purchasers of the loans. Moreover, the benefits they confer vary with various income groups. The richer a person, the more valuable the tax-exemption provision is to him. The floatation of tax-exempt securities means, therefore, an avenue for the rich to escape the tax, and even among the rich the advantage is to the rentiers.

The evil of tax-exempt securities has assumed alarming proportions in U.S.A. Constitutional provisions<sup>2</sup> and rivalries between States and the Centre have resulted in a colossal amount of such securities.<sup>3</sup> In India tax-exempt

1 "If the income tax had been applied in full to all future issues of these bonds, the increased interest cost would nearly offset the additional revenues secured". Report on Prevention of Tax Avoidance issued by Ways and Means Committee, 1934, quoted in Green, p. 65.

2 Green, p. 50.

3 On 31st August, 1933, the U. S. A. had tax-exempt securities amounting to about \$22,723 millions of which only \$12,860 millions were subject to super-tax. In addition, State and local bonds amounted to \$17,800 millions. These were exempt from federal income taxes by Constitution and usually also from the State income taxation by State laws.—*Ibid*, p. 65 fn. 10.

securities account for only a small part of the public debt. In 1940, the tax-exempt securities amounted to about Rs. 57 crores, and the income from them was only 1.6 per cent of the total income liable to income-tax. The interest on these securities is itself liable to super-tax, and is also taken into account in determining the income tax rates on other income.

### III. Anomalies and Problems of Indian Income Taxation

Upto now, we have been considering the general inequities arising from the practical difficulties in the task of computing income. These inequities have not been removed in many parts of the world, and if the Indian government erred, it at least had the consolation of doing so in honourable company. But there are many other cases where either because of its desire to favour its British masters, or to create in India a class favourable to its rule, or because of the exceptional Indian circumstances, the Indian government has added a great many other inequities to our income tax system. We shall examine here a few important ones.

#### Exemption of Agricultural Income

The most notable instance of this is the exemption of agricultural income from income tax.<sup>1</sup> : The Indian Income Tax Act has always specifically exempted agricultural income from income tax. While this is a necessity after 1937 because of the division of revenue resources between the provinces and the Centre under the Government of India Act, 1935, in the past it had no justification either in theory or in history. The Indian Taxation Enquiry Committee had recognized the grave injustice of this exemption, but had not recommended its abolition on administrative grounds and because of the prevalent feeling.<sup>2</sup> It is true that the agriculturist is less conscious of his income than the businessman, and to assess him is a task full of diffi-

<sup>1</sup> Sec. 4 (3) (viii).

<sup>2</sup> Report, paras 265-268.

culties. But on some such presumption as that adopted in U.K.,<sup>1</sup> the difficulty could have been got over. However crude the assumption, the bringing of agricultural incomes within the income tax fold would have meant a great improvement. The administration would not have been difficult, as only a small percentage of agriculturists has taxable incomes. In view of the present constitution, the best that the Central Government can do now is to take the income from agriculture into account in levying the rate on non-agricultural income.<sup>2</sup>

Income from agriculture has become a provincial source of taxation since 1937. The popular ministries in three provinces, Assam, Bihar and Bengal have dared break through the prevalent psychology, and have taxed income from agriculture. The controversy of generations has been set at rest. But still, equity has remained unsatisfied even in these three provinces. The rates of tax levied have been low, E.g., in Assam and Bihar the rates have been broadly the same as those on non-agricultural incomes under the 1939 Finance Act, but no super-tax is levied. Non-agricultural incomes are not taken into account in deciding the rate of the tax.<sup>3</sup> Madras is thinking of levying an agricultural income-tax. The other provinces, partly due to the suspension of popular Ministries and partly due to powerful influences of the landlords, have not yet followed this example. The income from this source is expected to be only Rs. 97 lakhs in 1945-46.

#### Treatment of Hindu Joint Families

Another problem, that has arisen from the failure of the Income Tax Act to adapt itself to the special circumstances of India, is the treatment of the incomes of joint

<sup>1</sup> For a full account, see Chap. VI.

<sup>2</sup> The Indian Taxation Enquiry Committee urged the adoption of such a practice, if it was "administratively feasible, and practically worthwhile. para 269. The Income Tax Enquiry Report, 1936, was in favour of this (page 7).

<sup>3</sup> As we have pointed out before, in deciding tax on non-agricultural incomes, agricultural incomes are not taken into account. This adds to the inequity.

family members.<sup>1</sup> / The Hindu Joint Family is considered by law only a "person," and has to pay income tax at the same rate as any other individual.<sup>2</sup> This has naturally provoked a great protest. The joint family is often composed of a large number of adult males, and to treat their joint income, as if it were the income only of one person, puts them to great hardship. To argue that the remedy of this injustice is with the members of the joint family only, that it is within their power to demand partition if they choose and thus be taxed at the rates appropriate to their individual incomes,<sup>3</sup> is callous. / It shows ignorance of that fundamental principle laid down by the U.S.A. Supreme Court that the power to tax must not be used as a power to destroy, especially so when the legislatures have not decided to destroy. We must, therefore, either give the joint family a certain allowance per coparcener, or, still better, treat it as a registered partnership of its coparceners. The latter course will give us a threefold advantage. It will remove the present grievance of the Hindu joint family. At the same time, it will remove two other inequities under the present tax system. At present, since the separate incomes of its coparceners are not taken into account when taxing the joint family income, the joint family income is sometimes, especially after the passing of the Hindu Gains of Learning Act, assessed at a lower rate than it would have been if divided among its members. Also, since the income of the joint family is not considered when charging the tax on the members' individual incomes, many persons having a good income from the joint family

1 The income-tax paying Hindu undivided families' income formed about 13% the total incomes of the income-tax paying class in 1938-39.

2 Income Tax Act, Sec. 2 (9). Before the Finance Act of 1939 the joint Hindu family was given a concession in Super tax, which commenced at a higher income level in its case.

3 "On the other hand, it may be pointed out that....disruption, with its consequent effect upon the Income Tax liability, is a matter entirely within its control"—Income Tax Enquiry Report, p. 24. In fairness to the Committee, it must be noted that in fixation of specimen income tax rates, they provided for each slab being double in the case of a joint family consisting of more than one adult married male member. They, also, recommended some other changes, revenue permitting, which would have removed much of this inequity.

property escape a part of the tax burden that they ought to bear. Though according to the concept of Hindu Law the joint family is much more than a partnership, as the number of co-sharers is fluctuating, this treatment is essential, if justice is to be realized. |

### Unregistered Firms

The treatment given to unregistered firms is another grave anomaly of our Act. While all the partners of a registered partnership are taxed on their total incomes at appropriate rates, unregistered partnerships are treated as individual separate entities. | There is no provision for refunds, where the share of a partner in such a firm is taxed at a greater rate than that warranted by his total income. This presses very hard on those, who have no income from other sources. Those, to whom partnership income is only subsidiary, are let off lightly. |

These two complaints received the attention of the Income Tax Enquiry Committee,<sup>1</sup> which made a powerful defence of the existing system. They pointed out that the taxation of unregistered firms as individuals was not due to any desire to discriminate against them, but due to the great difficulties that income tax authorities had in determining the terms of partnership, and the shares of the different partners in such a firm. To alleviate the seriousness of this evil, the Committee recommended that greater facilities be provided for registration, and that the public should be better informed about them. This would prevent the suffering of persons, who did not register their firms through ignorance or inertia. As for others, who still continued as partners of an unregistered firm, the only reason could be that their shares were nebulous, and this was their own fault. | In order to prevent evasion through creation of unregistered partnerships, the Committee recommended that power be given to the income tax officers to treat them as registered, if they were satisfied that non-registration

<sup>1</sup> *Ibid.*, pp. 20-22.

meant payment of a lighter tax in their case. This recommendation has been given effect to in the recent Act.<sup>1</sup>

### Individual Basis of Assessment

Another feature that distinguishes the Indian Income Tax from that in the United Kingdom is taking the individual as a basis of assessment. In U.K., the incomes of the husband and the wife are treated as one. They have the option, if they so choose, to have separate assessments but each will be charged on his or her income at the rate appropriate to the combined income. This had aroused very bitter controversy in Britain.<sup>2</sup> Why the position of two persons who marry should be rendered worse from the income tax point of view than that of the two living separately, or why two married persons living together should be treated worse than a father and a daughter or two sisters staying together was beyond the comprehension of many persons.<sup>3</sup> The controversy has now whittled down. It is now recognized that in modern society, husband and wife are welded together by stronger ties than any other two persons staying together, and that they have a much greater interest in common.<sup>4</sup> A common household of two is certainly cheaper than two houses of one each, and the services of the wife in kind render the household still cheaper. It is, therefore, quite correct to tax the two jointly. Moreover, the great possibilities of evasion, that the close relationship would render easy if the two were assessed separately, make imperative the taxing of the two together.

In India, the incomes of the couple are taxed separately. The Income Tax Enquiry Committee recommended

<sup>1</sup> Sec. 23 (5) (1). In 1938-39, the incomes of the unregistered partnerships liable to income-tax were only 4% of the total incomes of the income-tax paying class.

<sup>2</sup> How bitter the controversy was may be seen from the following remark made on this system by a member of a Royal Commission. "This is a beautiful relationship; let us tax it extra".—Report of the Royal Commission on Income Tax (1920), p. 153.

<sup>3</sup> *Ibid.*, pp. 153-160.

<sup>4</sup> If the incomes of the two are taxed separately, couples with equal incomes would pay unequal taxes.

that the family should be treated as one unit.<sup>1</sup> The Amendment Bill of 1938 made a provision for carrying out this recommendation.<sup>2</sup> The Select Committee, however, dropped it,<sup>3</sup> so that the position continues as before. The already elaborate provisions to prevent transfers of income between husband and wife have been made more elaborate.<sup>4</sup>

### Marriage and Family Allowances

The Indian Tax system provides no marriage and family allowances, which are essential both on ability and compensatory grounds. Since marriage is almost universal in India, we have no need of marriage allowances.<sup>5</sup> But child allowances are certainly a crying need. And the administrative objection that the absence of registration of births, marriages, and deaths in India will lead to great frauds<sup>6</sup> ought not to be allowed to stand in the way of this urgent demand of justice. It is certainly within the power of the Income Tax Officer to get a fairly precise knowledge of these things and frauds are likely to be few. Enquiries into the size of a family are no more of "inquisitorial nature" than other numerous enquiries that are made to-day by the tax officers. If it is not found possible to have flat rate allowances per child, at least we ought to be able to incorporate Dr. Rao's suggestion of giving allowances for school-going children.<sup>6</sup>

### Earned and Unearned Incomes

The need to differentiate between earned and unearned incomes had been urged repeatedly in India, but till March 1945 it had not found favour with the Government. The usual ground given for this rejection had been that we have no large class of rentiers depend-

<sup>1</sup> Report, pp. 19-20.

<sup>2</sup> Sec. 17 (i). There was one minor difference compared with U. K. Separate assessments for the husband and wife are at their request in U. K. here, they were provided for in every case.

<sup>3</sup> Report of the Select Committee on the Income Tax Amendment Bill.

<sup>4</sup> Income Tax Act, Sec. 16 (3) (1).

<sup>5</sup> Report of the Indian Taxation Enquiry Committee, para 241.

<sup>6</sup> Taxation of Income in India, p. 248.

ing on income from investments, and the larger part of this small class derives its income from land which has not been taxed. It was, therefore, unfair to treat differentially the small unearned income from non-agricultural investment.<sup>1</sup> This argument was surprising. To continue to exempt agricultural income inspite of its little justification in equity or history, and at the same time to refuse to introduce another measure of justice on this ground<sup>2</sup> was a travesty of reasoning. In 1945, however, a provision was made in the Finance Act for exempting on the British analogy one-tenth of the earned income from income-tax, the maximum exemption being Rs. 2,000.

### System of Graduation

The system of computing income tax in India suffered upto 1939 from another grave defect. It followed the 'step' system of graduation. Specified rates were laid down for the whole of the income, and not separately for different parts of the income. The result was that the tax payable did not rise gradually, but moved in jumps. Incomes just above a certain level had to pay a much higher income tax than those just below. For example, at the 1936-37 income tax rates, a man with an income of Rs. 15,500 paid a tax of Rs. 1,399 compared with that of Rs. 1,015 which a person earning Rs. 14,999 paid—an increase in the tax of Rs. 384 on an increase of Rs. 551 in income<sup>3</sup> i.e. a rate of 11 annas per rupee. There were even cases, where a person would actually be better off if he earned less. For instance a person with an income of Rs. 2,016 would, under the old system, have to pay an income tax of Rs. 63, i.e., his post-taxed income would only be Rs. 1,953. A person earning Rs. 1,999 only would retain his whole income. The Income Tax Act gave same relief in this extreme case, but could do nothing in less extreme cases of the first kind.

<sup>1</sup> Report of the Indian Taxation Enquiry Committee, para 242; Income Tax Enquiry Report, p. 15.

<sup>2</sup> "The case would be different if at any time incomes derived from agriculture were made liable to the tax."—Indian Taxation Committee Report, para 242.

<sup>3</sup> Income Tax Enquiry Report, p. 13.

To remedy this defect, the Income Tax Act has been amended since 1939. The system now adopted is the "slab" system, which we already had earlier with regard to super-tax. Income tax has now to be calculated on different slices of income, so that all the earlier absurdities have been removed. Only one such defect now remains; the first instalment of the tax starts at Rs. 1,500, though the exemption level is Rs. 2,000.<sup>1</sup> A person with an income of Rs. 2,001 will, therefore, have to pay a tax on Rs. 501 at the rate fixed, say at 9 pies i.e. a tax of more than Rs. 23.<sup>2</sup> To provide relief in such cases it is laid down that the income tax should in no case exceed half the amount by which the total income exceeds Rs. 2,000.

### Exemption Level

Since the income tax is best fitted to achieve justice in taxation, the ideal course is to begin to levy an income tax very near the lowest income group, which, we think, should contribute something to the State coffers. Administrative considerations, however, often rule out such a course. The trouble and toil consequent on bringing within the fold of income tax a larger number of assessees, whose tax payment per capita will be small, is not worthwhile at a certain stage. The exemption level has, therefore, often to be fixed much higher. (In case of India, we think, a level of Rs. 1,000 for unearned incomes will be feasible. The exemption level was in Britain before the war much higher—Rs. 3,600 for married persons with three children having all their income from investment and Rs. 6,000 when the income was wholly earned.<sup>3</sup> But the *per capita* income in U.K. is computed to be sixteen times that in India, and the cost of living for the classes in view, though not proportionately

<sup>1</sup> Since April, 1945, the exemption level for earned incomes is Rs. 2,222.

<sup>2</sup> Holds good now only of unearned incomes.

<sup>3</sup> The comparison made is between the general exemption level in India and the exemption level in U. K. of a married person with three children. This is necessary because of the absence of marriage and family allowances in India. *Vide Niyogi—Evolution of Income Tax in India*, p. 217.

high, is much higher than that in India.<sup>1</sup> In view of this, an exemption level of Rs. 1,000 should not be considered low even by the classes affected.<sup>2</sup> Besides it must be remembered that the question is not of the total money sacrifice, but of its distribution. The choice is not between a person of Rs. 1,000 paying no income tax and his paying one, but whether a person of the lower income group will bear a greater burden than he.<sup>3</sup> From the viewpoint of justice the choice is obvious.

### Rates

In the levying of income tax the problem of rate fixation is a very important one. Since income tax is the best instrument to realize a steeply progressive tax system, the rates must be fixed with proper regard to those considerations, which we have set out in Chapter I. The actual rates, that must be imposed, will depend on the degree of progression we want in our tax system and the incidence of other taxes on the various income-groups.<sup>4</sup>

The rates laid down in the Finance Act, 1939, did not pay sufficient regard to these considerations. The income tax that persons with different incomes paid during 1939-40 is given below. For purposes of comparison, a table showing the taxes that married persons with three children paid in U.K. in 1938-39 is also given.

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1 We do not imply that the States actually pay, or should pay, any great attention to the cost of living, except in so far as the costs pertain to necessities of efficiency. In a poor country, even the richer sections must learn to live on smaller incomes.

2 We are not taking into account the higher level of prices, which has more than doubled the cost of living to-day. Whether they are only a temporary phenomenon, which will end with the war, or whether a great part of them will be permanent will depend much on State policy, and cannot be exactly foreseen now.

3 It is the experience of almost all countries that the tax burden tends to be regressive among the non income-tax paying groups. A greater development of luxury taxation may, perhaps, partly remove this regression but in view of their elastic demand and other difficulties (vide Chap. VII), much cannot be expected.

4 As early as 1861, a Select Committee of the House of Commons pointed out the injustice of making "any alteration in the present incidence of the Income Tax without, at the same time, taking into consideration the pressure of other taxation upon the various interests of the country". Quoted in Report of the Royal Commission on the Income Tax (1920), para 7.

## Income Tax in India in 1939-40

Income.	Income Tax as percentage of Income.
Rs.	
3,000	2.3
5,000	3.3
10,000	5.0
15,000	7.9
25,000	11.0
35,000	14.1
55,000	19.2
125,000	27.7
200,000	32.5
350,000	38.7
500,000	43.0
1,000,000	51.2
2,000,000	55.3
3,000,000	56.6
Limit	59.4

Income Tax and Sur Tax in U.K. for 1938-39  
Married Couple with three children

Income	Earned Income		Investment Income	
	Tax in £ s. d.	Tax as % of income	Tax in £ s. d.	Tax as % of income
£ 300 (Rs. 4,000)	..	..	..	..
£ 400 (Rs. 5,333 $\frac{1}{3}$ )	..	..	3 6 8	0.8
£ 500 (Rs. 6,666 $\frac{2}{3}$ )	..	3 6 8	12 12 6	2.5
£ 1,000 (Rs. 13,333 $\frac{1}{3}$ )	..	95 2 6	150 2 6	15.0
£ 2,000 (Rs. 26,666 $\frac{2}{3}$ )	..	342 12 6	425 2 6	21.3
£ 5,000 (Rs. 66,666 $\frac{2}{3}$ )	..	1,504 10 0	1,587 0 0	31.7
£ 10,000 (Rs. 133,333 $\frac{1}{3}$ )	..	4,062 0 0	4,144 10 0	41.4
£ 50,000 (Rs. 666,666 $\frac{2}{3}$ )	..	29,499 10 0	29,582 0 0	59.2
Limit	75%			

From a comparison of the two tables, the following points emerge:—

(a) Though, as we have seen earlier, the Indian exemption level is much lower than that in U.K., once the British exemption level is passed the Indian income tax rates lag far behind. This is unfortunate, as the marginal utility of money falls rapidly precisely at those stages. Luxury taxation, however well-developed, can hardly compensate for this.

(b) Not only the rate of progression is lower in India but also the maximum rates are much lower. There is a

difference of as much as 15 per cent in the maximum tax rates.)

### Increase in Rates During the War

The great need for revenues during the war has compelled the Central Government to increase every year since the Supplementary Budget of 1940 the income tax rates. The percentage of income, that will have to be paid by various income groups for the year 1945-46, is shown below:—

Income.	% of Income paid by way of income and super taxes.	
	Earned Income	Investment Income
Rs.		
3,000	3.1 <sup>1</sup>	3.9 <sup>1</sup>
5,000	4.7 <sup>1</sup>	5.5 <sup>1</sup>
10,000	8.0	9.2
15,000	11.3	13.5
21,000	15.3	18.1
30,000	21.7	23.7
50,000	33.6	34.8
70,000	41.6	42.5
1,00,000	48.4	49.0
2,00,000	59.7	60.0
3,00,000	66.4	66.6
5,00,000	73.6	73.7
10,00,000	84.4	84.5
20,00,000	89.9	89.9
30,00,000	91.7	91.7

A glance at the table will show that the earlier defects still persist. The progression in rates at the earlier stages remain little. The maximum rates, however, are now considerably more satisfactory. We hope that this feature of the war-time income tax structure is retained in the post-war period.

### B. PARTIAL INCOME TAXES

#### Employment Tax

(a) **Flat Rate Taxes:** The Government of India Act 1935, made the tax on "professions, occupations, and employments" a provincial source of revenue; and some of

<sup>1</sup> The actual burden on persons with incomes between Rs. 2,000 and Rs. 6,000 was lower by  $\frac{1}{2}$  per cent, as this amount was funded for their benefit, and was to be returned to them after the war.

the provinces were not slow to take advantage of this. The Central Provinces were the first to act. By the C.P. and Berar Finance Act, 1938, every person carrying on a trade, business, or profession either by himself or through his agent, or in employment in the province, and assessed to income tax in British India during the preceding year, had to pay a quarterly tax of seven rupees. Bengal followed this example, and in the Finance Year 1939 levied a similar<sup>1</sup> tax of Rs. 30 a year.

Since the taxes are levied at a flat rate on all persons having incomes above the exemption level, which is far above the level of subsistence, there is no chance of their being shifted. They will rest on the taxpayers, and will be felt as burdensome by the lower income groups.

(b) **Progressive Rates:** The more interesting attempt in the direction, which however did not succeed, was that made by the United Provinces Employment Tax Bill, 1939. The tax was to be levied on all salaries exceeding Rs. 2,500 earned in the province. Various scales of taxes were laid down for different income groups. The rates were progressive, and amounted to as much as 10 per cent. on the higher incomes. The tax varied from the Central Government income tax in two important respects:—

(a) It was not to be levied on or with reference to the total income of an individual but only on the salary earned in the province by him. (b) The amounts of tax to be paid were not laid down as so many pies per rupee, but they were fixed in lump sums for various income groups. However, as the limits were very narrow in the lower groups, this did not make a great difference.<sup>2</sup>

The tax being on all salaries earned in the province, there was no alternative taxless field to which the poten-

<sup>1</sup> There was, however, one important difference. Under the C. P. Act, 1938, a person paying a similar tax imposed prior to 15-2-38 by any local authority had only to pay the difference to the Provincial Government. In Bengal, he had to pay the entire tax.

<sup>2</sup> For a fuller discussion, *vide Report of the Resources and the Retrenchment Committee, Punjab Government*, para 206.

tial taxpayers could go except to another province,<sup>1</sup> or to some private business.<sup>2</sup> Migration to another province for a high salaried man is very difficult; starting one's own business, though it cannot be entirely be ruled out, is only possible in a few cases. The tax was, thus, likely to rest on the tax-payer himself. The salaried person, who is considered as deserving of special consideration in other countries, would have been heavily penalized.

The Governor-General, for whose consideration the Bill was reserved, felt that such a tax would seriously impede the taxable capacity in the Central field. The right course in this case would have been a reference to the Federal Court. Instead, the Parliament was made to intervene, and limit the provincial power to tax professions, etc., to a limit of Rs. 50 only. In view of this limit, no experiments on the U.P. lines are likely. The tax is expected to yield only Rs. 12 lakhs in 1945-46.

### Property Tax

In addition to the Agricultural Income Tax and the Tax on Employment, some of the provinces have also imposed a tax on urban immovable property. The first in the field was the Bombay Government, which, in order to finance its prohibition scheme, imposed a property tax in Bombay and Ahmedabad. The rate of the tax was originally fixed at 10 per cent on the net rental value. In case of properties yielding less than Rs. 2,000 per annum, the tax was to be levied at 5 per cent only. In view of the increase in excise revenues consequent on the relaxations in the prohibition policy necessitated because of the High Court decisions, the taxes were progressively reduced, till in April 1944 they were levied at 7 per cent and  $3\frac{1}{2}$  per cent respectively. In 1945-46 budget the link between the excise revenues and the rates of the property tax have been snapped. The

<sup>1</sup> In the case of C. P. and Bengal employment taxes, we have not taken up this question, as they do not amount to more than  $1\frac{1}{2}$  per cent at the most.

<sup>2</sup> A joint stock company could not have helped, for directors, agents, and corporations were considered as employees for the purpose of this tax.

Punjab levied an Urban Immovable Property Tax in 1940. The tax is estimated to bring in 129 lakhs of rupees in 1945-1946.

The incidence and justice of a tax on rent are hard to determine. The supply of housing accommodation is inelastic. In the growing cities, the demand for them is always rising. In view of this, the property owners sometimes get greater than fair returns. A tax on rent in such a case cannot lead to a decrease in house-building activity, is not likely to be shifted, and is not unjust. But even where the houseowners are only getting a fair rent, the shifting is likely to take time. In such a case, both in its effects and in its incidence, the tax will prove undesirable. The property owner will be taxed heavier than other persons with equal incomes from other fields of investment. This will have an effect on the housing activity in the long run, and the shortage of housing accommodation may become chronic. The profits made by property owners in cities where the property tax is imposed are not known, and therefore no conclusion regarding the actual incidence is possible. The Bombay Act has, however, made shifting impossible, at least illegal<sup>1</sup> in those cases, where the rent paid by a tenant was less than Rs. 80.<sup>2</sup> In view of the failure of the Bombay Rent Enquiry Committee to come to any conclusion on the question of returns to property owners from their property,<sup>3</sup> this was unwise.

<sup>1</sup> Illegal is not necessarily impossible, not even improbable. In Bombay City, during the years 1918-1928, when rents were restricted, a considerable amount of evasion took place through the "pagee" system.—Report of the Bombay Rent Enquiry Committee, para 81.

<sup>2</sup> By Acts issued under the powers granted to them under the Defence of India Act, the Bombay and the Punjab Provincial Governments have now restricted rents in most cases as a wartime exigency. The purpose as well as the operation of these Acts are very different.

<sup>3</sup> *Ibid.*, para 75. Their suggestions in paras 119 (b) (ii) and 120 (b) (ii) of reducing rent in case of certain categories are rather inconsistent with this; but in making those recommendations, they were perhaps led more by humanitarian than scientific considerations.

## CHAPTER IV

### DEATH DUTIES

#### I. Incidence of Death Duties

Both because of their great revenue-yielding capacity, and because of their being, next only to income tax, most adaptable to the needs of equity, death duties have by now come to occupy a very important place in the tax systems of many countries. The term "Death Duties" however connotes a number of different taxes levied on entirely different, and even conflicting, principles and to decide between the rival claims of all these is only possible after knowing their incidence.<sup>1</sup> Unfortunately, even here as in the case of income tax, widely different opinions are held. The position is much worse, since there are four distinct opinions, all backed up by great authorities.

##### (a) Incidence on the Successor

The first view widely held has been that the burden of the death duties falls on the successor.<sup>1</sup> The deceased is dead and gone, and cannot, therefore, pay the tax.<sup>2</sup> He might not at all have cared about the tax, which was to be paid only after his death. The person, who really suffers due to the tax, is the successor, who inherits less because of the tax. If the tax were to be abolished, it is he who would be really benefited. It is, therefore, he who bears the tax.<sup>3</sup>

This contention is hard to accept. The time of the payment of the tax or the person likely to benefit by its abolition can, certainly, be no criterion of its incidence. As

1 Cf. "It is of some practical importance to judge between the two (rival theories), since the point of issue has a bearing on the equity of the duty". Report of the Committee on National Debt and Taxation, para 453.

2 "The predecessor must be dead before the tax can be levied and dead men, like inanimate objects, can pay no taxes". Dalton, p. 53.

3 A tax is paid by "those who would be benefited if it were taken off". Mill, Principles of Political Economy, p. 825.

we have seen earlier, the abolition of a capitalized tax will result in an undeserved bounty to the new owners of the taxed property. Yet, it has never been contended that the incidence of such a tax is on those, who have purchased the property after the imposition of the tax. On the contrary, economists are unanimous in holding that the burden in such a case is on the original owners.<sup>1</sup> It is true that death duties reduce the amount of property left to the successors. But, a high income tax on the deceased's income may have similar effects. And yet nobody would regard the incidence of this as falling on descendants. Dalton's theory is equally implausible and puts an unduly high premium on the time of payment. In the process of capitalization, we must remember, not only the actual tax payment but even future tax payments are discounted at the time of purchase.

#### (b) Incidence on the Deceased

Another well-supported view has been that the incidence of death duties is on the deceased. The estate passing at his death is the result of his abstention from consumption. He could have, only if he had so desired, spent away his money. His inheritors could not have prevented him from doing so. The children, much less the other relatives, have no natural right to such property, nor have they any ethical or social claim on it except perhaps in so far as it is essential to support them during childhood, and give them an adequate education to enable them to earn of their own accord. The economic defence of inheritance is never based on the inheritors' right; it is founded on the desire of parents to provide for their children. It is true that in our present society, an inheritance tax is regarded as a burden by the successors; but that is only, because they have been accustomed to look upon the properties of their parents as their birth right. When the death duties

1 Mill himself recognized this with regard to land. "All, who have bought land, since the tax existed, have bought it subject to the tax. There is not the smallest pretence for looking upon it as a payment exacted from the existing race of landlords". p. 820.

become a fixed part of the tax system, the expectations of the heirs will be toned down. The death duties are a limitation only of the predecessor's right to dispose of his goods after his death. The burden of these duties is, therefore, on him only.]

#### (c) No Incidence

There is a third view, viz., that nobody bears the burden of death duties. The predecessor is dead, the inheritors have no natural right to succession. Death duties are therefore an impersonal form of taxation falling on the estate.

This view is logical, and there is something to be said for it. Since, however, for all practical purposes, we must relate the burden to somebody, and [since there can be no revenue without an 'incidence',] we must reject this view.]

#### (d) Colwyn Committee Report

An entirely different view of the incidence of death duties was taken by the Colwyn Committee,<sup>2</sup> and following them, by some eminent economists. The Committee made the provision of payment for death duties the criterion of their incidence. {If the deceased, through harder working and/or greater saving, made provision for payment of death duties, the burden lay on him.) If, however, he went on living as he would have in absence of the tax, caring little for what happened to his estate and his successors, (the incidence lay on the successors.) Usually, there is no evidence of whether the deceased provided for the payment of death duties in his lifetime, and therefore no possibility of correctly judging incidence. (Only in case of persons insuring to a sufficient amount, it could be said with confidence that they paid their own death duties.) In other cases, no statement either way could be emphatically made. Whether an individual would

1. "For practical purposes, however, it is clearly necessary to relate the incidence to some individual". Report of the Committee on National Debt and Taxation, para 460.

2 *Ibid.*, paras 452-461.

attempt to earn more and save more for his death duties is to a great degree a matter of personal equation. Certain broad rules can, however, be laid down. Where the duty is heavy, there is a greater likelihood of some provision being made for its payment. Where a person's estate consists of landed wealth or some trade assets, he is more likely to provide for its payment, for he will not like to visualize its break-up. Where, however, the estate consists of securities, no such feeling will accentuate the desire to make provision. Much also depends on the degree of relationship between the deceased and those likely to succeed him. The more remote the relative likely to succeed, the less the natural affection for him, and the smaller the likelihood of any efforts on the deceased's part to see that the inheritors do not get less because of the tax. Thus, the incidence of the death duties is varying. (On the whole, however, the incidence of an Estate Duty is, according to the Colwyn Committee, on the deceased.<sup>1</sup>)

The line of reasoning adopted by the Colwyn Committee seems to us to be full of danger. In case of no other tax, we make provision of its payment a criterion for its burden; in no other case, we so confuse the effects with incidence. If any such course were to be adopted in case of income tax, the Colwyn Committee would have been the loudest to oppose. Perhaps, death duties were thought of by them as a special case, where rules applying to other taxes were no longer valid. But nowhere do the Colwyn Committee make clear their grounds for regarding this case as exceptional. Our conclusion, can, therefore, only be that there were no such reasons.

(We, therefore, take the second view that the incidence of death duties lies always on the deceased.)

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1 Only a few paras later, the Committee contradict themselves. "In general it (the Estate Duty) is decidedly more neutral in its effect (on saving and work) than taxation of income". Para 529; also para 533. If Estate Duty does not lead to more saving or greater hard work, how can the predecessors be said to provide for it, and how can it be said that "we have good support for giving primary but not exclusive place to the notion that the incidence of the tax is on the predecessor"?—para 459.

## II. Demerits and Merits of Death Duties

### Defects of the Property Tax

Death duties have been described as an ("occasional property tax,"<sup>1</sup>) a property tax levied on the occasion of the death of the property owner, and as such they suffer from all the defects inherent in a property tax. We have regarded income as the criterion *par excellence* of ability to pay. A property tax, in our present social system, militates against this. In an age where there are great diversities in the form of property, and the income-yielding capacities of properties are widely different, the property tax by hitting properties equally leads to inequity.

### Defects of the Occasion

(a) Frequency of Deaths: The occasion, which the death duties select, gives rise to even greater objections. Deaths occur at different intervals in different families. In families, where the frequency of death is greater, these duties will have to be paid oftener. Thus, misfortune or some family defect may lead very near to a wiping out of the estate. If three deaths occurred in a family in fifteen years, even a moderate duty of 30 per cent will reduce the estate to merely 1/3rd, whereas other normally situated families will have their estates reduced at most to 7/10th. This argument, however, may be easily given an undue importance. Quick deaths in a family are usually followed by long-separated deaths and *vice versa*. If a grandfather of 80 dies leaving behind him a son of 55 and a grandson of 30, deaths may well follow one another in quick succession. The son may die at 60 and the grandson at 40. But the great grandson of 15 will have a long lease to run. (It has been estimated in U.K. that out of 6,000 estates exceeding £10,000, only 3 per cent change hands twice within five years, 5 per cent within the next five, and 7 or 8 per cent within another five, so that only 15 to 16 per cent estates pass a second time within fifteen years.<sup>2</sup>) In these few

<sup>1</sup> Pigou, p. 158.

<sup>2</sup> Colwyn Committee Report, para 482.

cases, of course, hardship does occur, and it is little consolation to tell the inheritors that according to the law of probability their sons and grandsons will die at greater intervals paying duties less often, thus compensating the estates for the frequent payments they had themselves to make out of them. The law of probability works *en masse*. and is no guarantee of lack of individual hardships. To mitigate cases of extreme hardship, clauses reducing the estate duty have been inserted, e.g., (in England, if the second death occurs within one year of the first death, tax reduction of 50 per cent is made, if within the second year 40 per cent. and so on, until if the death occurs in the fifth year a relief of 10 per cent is provided.<sup>1)</sup> In U.S.A. the Federal law goes further, and exempts such an estate entirely.<sup>2)</sup> While the relief may be extended, the fundamental inequity due to the particular occasion of death duties cannot be fully remedied by tax relief. Insofar as resort is had to insurance method, this inequity is greatly removed.

~(b) **History of the Estate:** (The history of the acquisition and the growth and development of the estates is ignored entirely by the death duties.) Their burden, however, will widely vary according to this factor. Two estates, one of which has been rapidly acquired and long enjoyed by the owner, and the other slowly and painfully built up and little enjoyed, will have to pay equal death duties, though their abilities to bear taxes must be regarded as different.

~(c) **Fluctuations in Value of Estates:** Death duties are usually computed on the value of the estate at the time of death. The wild day-to-day fluctuations in the value of the shares yielding a fixed interest, and the only relatively smaller fluctuations in the value of the other bonds have a great influence on the value of the estate. Thus, the actual time of death, which has little to do with the capacity of the estate to pay, will be an important factor in determin-

1 Shirras—Science of Public Finance, Vol. II, p. 575.

2 *Ibid.*, p. 575.

ing the amount of the duty. "Die if you must, but choose the actual moment of your death well" will be the advice of the prospective inheritors to their predecessors.

(d) **Change in Rates:** (The duties to be paid are determined according to the rates in force at the time of death, so that where the amount of the duty is often changed, the time of death will have in another way an undue influence.) For instance, if the estate duty is raised from 30 per cent to 40 per cent in March 1925, a person leaving an estate of Rs. 1 lakh in February 1925 will have to pay Rs. 30,000. If his evil stars, or rather those of his inheritors, prolong his life to April, his estate will be subject to a duty of Rs. 40,000. Such changes are very likely in the early history of death duties, when the State is experimenting with them. After a time, the duties are likely to be stabilised and no frequent changes are likely. However, some need for change may be felt at some interval, and then this injustice is bound to result.

#### Mitigation of the Defects

Death duties thus suffer from the special defects of their own due to the time of their imposition besides the general grave defects of the property tax. This very occasion, however, detracts much from their odious character. A tax, which is imposed at death, need not come up to those standards of equity which we should demand in other taxes. Since it does not fall during one's own lifetime and is felt only by the successors who have often just come into a happy financial position it may be forgiven much not only by the taxpayers but even by the economists.<sup>1</sup>

#### Advantages of Death Duties

(a) **Differentiation Among Unearned Incomes:** Death duties, moreover, provide an important supplement to income tax as tools in the realization of fiscal justice. Income,

<sup>1</sup> Cf. "A tax payable on an estate in transit does not require so meticulous a standard of equality as a tax levied directly on the living taxpayer." —Colwyn Committee Report, para 495.

as a criterion, has some defects of its own. The meaning attached to it in many countries adds to these. Death duties properly levied serve as a valuable corrective. For instance, take three persons earning Rs. 3,000 each, the first from Government securities, the second from an ordinary business, and the third from a risky undertaking. These three persons will have to pay practically the same income tax, though there will be almost unanimous agreement that owing to the smaller or greater precarious element in their incomes their abilities vary, that of the first being the greatest. It is true that under the ideal tax system this difference will in part be compensated for by the greater number of times the person having a secure income will have to pay. But, this is not sufficient. Under our present tax systems with their giving up of the "average" basis, with their progressive rates and high levels of exemption, the incomes from risky sources are unfavourably treated.<sup>1</sup>

(Persons getting their income from safe sources get off lightly as compared with persons having risky sources of income. Death duties, even like property taxes, remedy this injustice to some extent. Since the more risky the investment, the greater the ratio that income will bear to capital, under a tax on property, persons with safe incomes will have to pay a greater amount of tax than those with equal incomes from unstable sources.)

(b) **Taxation of Consumers' Capital and other Non-monetary Utilities:** We have also seen that under our present income tax system, consumers' capital, with the exception of houses, is not taken into account. This rule is based on expediency, not on justice, for even non-monetary income provides as valuable utilities, and satisfies as intense wants as monetary income. The satisfaction, which a person may get from seeing pictures in his house may be greater than that which he would have obtained by the income derived from the investment of the savings he would have otherwise made. There is no reason why while tax-

<sup>1</sup> We have shown in the previous chapter how no provision for losses can adequately compensate for this.

ing the latter we should exempt the former from a tax. In the computation of the estate, this capital insofar as it has remained intact is counted, so that the injustice of the present income tax system is partly removed.

Besides this consumers' capital, there are also sources of psychic satisfaction, which do not reflect themselves in monetary income. Considerations of prestige, ideas of sanctity, and various other sentimental ties may make the value of property greater than the capitalized income from it. Death duties will tax these also. Insofar as these psychic utility-yielding sources are proper objects of taxation, death duties have one more point in their favour.

(c) **Differentiation between Earned and Unearned Incomes:** The case for differentiating between earned and unearned incomes is, as we have seen, sound. Recognition has been given to it in the income tax laws of various countries. But the differentiation so far provided has been, in many cases, felt to be insufficient. It is not possible to satisfy the public demand in full through the income tax laws because of the great adverse effects on saving that a greater differentiation may have. (Death duties enable the better fulfilment of this desire.) This concept of death duties as a deferred income tax on unearned incomes was prevalent in U.K. even at the time of the first imposition of death duties. The analogy, however, must not be pressed too far; the great interval for which the tax is deferred makes much difference in the situation. Nonetheless, the analogy is true to an extent.

(d) **Capital Gains and Losses:** In the last chapter, we have examined the necessity of including capital gains in the computation of income, and come to the conclusion that such gains (along with losses of course) must be included, as their exclusion means partial exemption of the rich. Nonetheless, on administrative grounds, many countries have thought it wise to exclude this category from "income." (Capital gains, if they are not spent up during the lifetime of the gainer, will have to pay death duties.) The claims of justice, thus, will be partially met.

### III. Various Forms and Rates of Death Duties

#### Forms of Death Duties

We have earlier come to the conclusion that the incidence of death duties lies on the deceased. But death duties levied on considerations other than the value of the total estate of the deceased are common in many countries. It is essential to remember that even in U.K., where the estate duties form a very important part of the death duties, another principle, viz., the relationship of the successors is recognized in the Legacy and Succession Duties.<sup>1</sup> In the U.S.A., in the Federation the estate tax is adopted,<sup>2</sup> about the U.S.A. States nothing in general can be said.<sup>2</sup> In France, the former estate tax has been abolished, and a succession tax varying with the amount of inheritance and the degree of relationship has been established.<sup>3</sup> Germany follows the same principle.<sup>4</sup> Thus, we have three distinct methods of levying death duties in force: (1) the estate duty, where the duty is levied entirely in accordance with the size of the estate left, irrespective of the share of each inheritor or his relationship to the predecessor; (2) and (3) an inheritance duty, where the amount to be paid depends on the share of each successor either in conjunction with his relation to the predecessor or independently. In theory, we can further visualize two more varieties: (4) an inheritance tax on the inheritance adjusted according to the wealth the inheritor possesses at the time of inheritance—a scheme fervently advocated in some quarters, and highly beneficial from the distributional point of view; and (5) a tax on estate according to the "age of the estate," or "progressiveness according to time"—the scheme devised by

1 The English Legacy and Succession Duties are levied at 1 per cent where the beneficiary is the husband, wife, lineal issue or ancestor of the predecessor, at 5 per cent where the beneficiary is a brother or a sister or a descendant of either, and 10 per cent in other cases.

2 *Facing the Tax Problem*, p. 23.

3 Green—*The Theory and Practice of Modern Taxation*, pp. 230-231.

4 *Ibid.*, p. 287.

Rignano<sup>1</sup> and ably improved upon by Dalton.<sup>2</sup> These various forms of Death Duties besides the Estate Duty are justifiable on varying grounds. Inheritance is a gratuitous acquisition or windfall, so that on the principle of "special ability" it is quite correct to tax the share of each inheritor. The more remote the relation, the greater the element of the windfall. Both because of this, and because of its smaller effect on the predecessor's willingness to work, a greater tax on distant relatives is justifiable. A tax on a windfall may be levied either according to the amount of the windfall regardless of the previous position of the person to whom it accrues, or it may be levied according to the previous income or wealth of the owner. The second and fourth types of the tax are based on these two different principles. The fifth suggested plan of duty is entirely based on considerations of effects. A person is more interested in the near future than in the remote one; he is interested more in his son than in his grandson, and more in the latter than in the greatgrandson. A tax falling on the inheritance that a person may leave to his grandson will affect him less adversely than one on the property he will leave to his son. A death duty, which is very heavy, must take this principle into account.

#### Rates of Death Duties

There is no hard and fast rule about the rates of death duties. From the point of view of justice alone, we may tax even upto cent per cent; but the announcement effects such a duty would have make this action unwise. Even as in the case of income tax a certain exemption so as to leave out very small estates is desirable. In cases, where the successors have a special right, the exemption may be increased; e.g., in the U.K., where the Estate Duty begins generally after £100, in cases where the beneficiary is

<sup>1</sup> See Rignano and Stanip—The Social Significance of Death Duties, pp. 37-40.

<sup>2</sup> See his evidence before the Colwyn Committee Report, para 929. See also Henderson—Inheritance and Inequality, pp. 17-26.

a widow or a child under 21, the limit is raised to £2000.<sup>1</sup> A certain progression in death duties is essential; but as to the degree of progression and the steps, it is difficult to say anything. These have to be fixed with detailed regard to considerations of effects. The only principle that can be laid down in the matter is that the progression in rates must be sufficient when taken up in conjunction with the income tax rates to so counteract the regressive nature of other taxes as to effect the desired degree of progression in the tax system as a whole. The practices followed by different countries vary partly because of this fact, and largely because of political expediencies, historical reasons and a failure to have any tax principles at all. In Great Britain, the exemption is low and the highest rate, viz., 55 per cent<sup>2</sup> was reached early at £2 millions. In U.S.A., the exemption level is higher, and the highest rate 70 per cent is levied over estates of 50 million dollars and above.

So far we have discussed only the rates of estate duties. But various other forms of death duties, as we have already seen, are feasible and two of them are widely practised. A tax on each inheritor varying with the sum left to him must be steeply progressive, if it is to yield a sum anywhere near the estate duties. As an inheritance tax, varying with the degree of relationship that each inheritor bears to the deceased, is based on the principle of windfalls, there is not much to say regarding its rates. Where the tax also varies with the amount each person inherits, the rates of duty in case of a beneficiary closely related to the deceased will be less than in the case of estate duties; e.g., in France, the highest rate that a widow or widower is charged is 25 per cent only. What cannot be easily understood is that even in case of strangers in blood, the limit is 40 per cent. The great emphasis on the effects of the duties according to the degree of relationship between the inheritor and the deceased is not much worth in such a case. The right thing in principle would be to go, at least in cases where this rela-

<sup>1</sup> Shirras, p. 563.

<sup>2</sup> The tax was raised to 60% in Sept. 1939, and 65% in July, 1940.

tionship is very remote, upto somewhere near Bentham's proposal. 80 per cent in case of strangers in blood will be reasonable. The rates in case where the inheritor is taxed according to his present income or capital must be progressive and their maximum high. Rignano's plan, though never practised so far, would, if administratively feasible, allow us to approach the theoretical ideal of 100 per cent in the third or fourth generation; its present worth, however, would not be very heavy.

#### IV. Death Duties in India

##### Scope of Death Duties

In India, we have no death duties in the proper sense of the word. As yet, we have only duties on probates, letters of administration, and succession certificates. The circumstances under which a probate, a letter of administration, or a succession certificate has to be taken out vary with different religions and even within the same religion they are not the same. The necessity of issuing them is decided by extraneous considerations having nothing to do with income. The whole position is regulated by a number of laws, and is rather complicated. Broadly speaking, however, it may be summarized as follows. The Administrator General's Act requires the Administrator General to obtain letters of administration in every case where a person, who is not a Hindu, an Indian Christian, a Parsi, a Buddhist, or a Mohammedan, dies leaving a property of more than Rs. 1000, if no person qualified to obtain a probate or a letter of administration applies for it. The effect of this is to render the estate of such persons liable to death duties in all cases. The Indian Succession Act makes the payment of duties indirectly compulsory in some other cases. According to it, the production of a probate along with the will or an authenticated copy thereof is absolutely essential to establish one's right as an executor or a legatee of the estate of the deceased.<sup>1</sup> Where the deceased has made no will, letters of administration are necessary to prove any

<sup>1</sup> Indian Succession Act, 1925, Sec. 213.

right to the property of the deceased.<sup>1</sup> One must remember that this only means compulsory probate, letters of administration, etc., in those rare cases, where resort has to be taken to court, and according to court rulings that too only when the representative or the successor of the deceased has to appear as the plaintiff. The narrow scope of this Act is further restricted by special provisions for the major religions of India. The Hindus, Jains, Sikhs and Buddhists need no letter of administration in case of intestate succession.<sup>2</sup> Probates are essential in their cases only if the wills are made within the territories of the lower provinces of Bengal or within the local limits of the ordinary civil jurisdiction of the High Courts of Bombay and Madras, or if they deal with any immovable property situated therein. The Mohammedans are exempted from the odious duty of issuing probates etc. in all cases.<sup>3</sup> The position of the Native Christians is the same as that of the Hindus regarding letters of administration, but in case of wills probates have to be taken.<sup>4</sup> The Parsis have been the least fortunate of all the Indian communities. They have no special exemptions. In addition to these provisions, the Succession Act makes a special provision to "facilitate the collection of debts on succession and afford protection to parties paying debts to the representatives of deceased persons."<sup>5</sup> Under this section, the Court will not grant a decree or order its execution against the debtor of a deceased person for payment of the debt to the person claiming to be entitled to it, unless he produces a probate, a letter of administration or a succession certificate. Thus, where resort has to be sought to courts for realizing the debt of the deceased, if a probate or letter of administration has not been issued, a succession certificate will have to be taken out.<sup>6</sup> But the scope of this provision

<sup>1</sup> Indian Succession Act, 1926.

<sup>2</sup> *Ibid.*, Sec. 212.

<sup>3</sup> *Ibid.*, Secs. 212 (2) and 213 (2).

<sup>4</sup> Sec. 212 (2) and 213.

<sup>5</sup> Sec. 214.

<sup>6</sup> Certificate cannot be issued where otherwise a probate or a letter of administration should be issued—Sec. 370.

is limited. A person has to apply for a certificate only for the amount of the debt he wishes to recover, and not for the whole of his estate. Once he has obtained a certificate for one debt, he can extend it to other debts as occasion arises on payment of duty on these further debts (only 1 per cent duty has to be paid). Moreover the certificate is not a preliminary condition to the admission of the suit; and because of the delay involved and no consequent advantage to them, the debtors are often led to pay off the debt or renew the promissory notes in the new creditor's name, before the case comes to the final stage. Often creditors, who have obtained a certificate for the payment of one debt, compel other ignorant debtors with its help to pay off their debts.

Besides these, we have various acts like the Government Savings Bank Act, the Provident Funds Act, the Post Office Cash Certificates Act, and the Imperial Bank Act, under which the bodies concerned can insist on the production of a probate, etc., before paying money or transferring shares to the heir of the deceased. This necessity is often avoided by the use of joint names with "payable to either of the survivors" clause, which enables the survivor to transfer to his own name the accounts or the share on the production of a simple death certificate.

Grading the communities according to the burden of death duties, we get the following order:

(a) The most burdened are the Europeans, the Jews, the Armenians and persons of foreign domicile, whose successors have to pay the probate fees in all cases where the estate left is worth more than Rs. 1,000.

(b) Next come the Parsees, who have to obtain probate etc., and pay the duties in all cases, where a right has to be proved in a Court of Law.

(c) Next in order come the Indian Christians, who have to pay probate duties, if the estate becomes a subject-matter of dispute, in case where there is a will. In cases of intestate succession, a duty will only have to be paid

to the extent of a debt for which a decree is sought or has to be executed.

(d) The position of the Hindus regarding intestate succession is the same as that of Indian Christians. Where, however, a will is made no probate is essential to prove a right in a Court of Law except in very limited cases.

(e) The most favoured are the Mohamedans, who need pay no duties except if and to the extent that they wish for a court decree in realizing the debt of the deceased.

This position is very anomalous and annoying. That a modern State should tax a person according to his religion is an abominable and unbelievable idea to most of us. The Taxation Committee drew pointed attention to the evils of such a system; and many spirited protests have been made against it,<sup>1</sup> but to no avail. Besides this religious discrimination, our present probate duties are, in most cases, court fees only. Those, who, because of the wisdom of their ancestors or because of their own good fortune have not to go to law, are greatly benefited. Lack of foresight on the part of the deceased or bad luck are too severely punished. The exercise of the right to make a will is severely penalized in case of the Indian Christians, and to some extent in the case of the Hindus. The sooner we abolish such a system the better for us.

### Rates of Death Duties

Probate duties being of such uneven incidence in our country, their rates, past and present, are of little importance. Upto 1910, they were levied at a flat rate of 2 per cent in respect of all properties worth more than Rs. 1,000; in 1910, however, the rates of the duties were made to rise up gradually from 2 per cent to 3 per cent. Under the Montford Constitution, the power to amend the Court Fees

<sup>1</sup> "I do not see why, when I die, my son, who may inherit Rs. 5,000 has got to pay Rs. 100 or Rs. 150 to the Government, whereas the son of any one of these Honourable gentlemen who may inherit a million, escapes entirely if he is a Hindu or a Mohammedan. There is a racial discrimination, if you like. We are fighting for the removal of social distinctions; let us fight on this point" (Ginwala's speech in Legislative Assembly, 1923, quoted in para 56 of Appendix XII to the Indian Taxation Enquiry Committee).

Act was delegated to the provinces, and they were not slow to increase the duties. The rates to-day vary with different provinces, but before the war they all began with 2 per cent; the highest rate was 7 per cent.<sup>1</sup> The moderation of these rates is essential in view of the evident injustice of the tax. These duties yielded Rs. 36 lacs in 1923-24, the last year for which figures are available. While the increase in rates made since then must have increased revenue from this source, the limited scope of the fees must have prevented the duties from becoming a first class source of revenue even now.

### Opportunity Lost

Under the 1935 Act, taxation on succession to property other than agricultural land is a central matter, while duties in respect of succession to agricultural land belong to the provincial field. In both cases, the tax proceeds go to the Provinces. The Government of India, in order to have a uniformity between taxation on the two types of property and to evolve a suitable form of inheritance taxation sent round Sir H. Lloyd in 1939 to consult the provincial governments. Strangely enough, all of them except Assam, Sind and Orissa were against the imposition of such a tax. When one remembers how hard pressed the governments were for more sources of revenue, and how eagerly they tried to tap all possible avenues of revenue, one finds it very hard to understand this refusal. The only objection to the evolution of a proper estate taxation could have been administrative, chiefly the different laws of succession and inheritance in India, the existence of the joint family, the widow's estate in the husband's property, and the Stridhana in Hindu law. As the Indian Taxation Committee had shown,<sup>2</sup> while these made the task of imposing any succession duty,

1 During the war period these have further been increased in some Provinces.

2 Report, paras 356-57 and 373-375. The more important note by the Legal Adviser to the Committee is printed as Appendix XIII of the Report.

impossible, the problems created could easily be got over in case of an estate duty.<sup>1</sup>

Apart from the revenue that has been thus missed, we have also lost one of the two powerful means of attaining progression in taxation. We have already seen how the income tax rates in England are more progressive. Add to this the following table showing the tax on income imposed by death duties; and one can see how great an opportunity to combine justice in taxation with productivity is missed in India.

Burden of Death Duties in U. K. (1925-26).<sup>2</sup>

Income	Death Duty as equivalent of income tax per £		Percentage of income given by way of death duties	
	All income from investment	Half earned, half un-earned	All investments	Half earned, half un-earned
£100	0 5½	0 2½	2.3%	1.1%
£150	0 5½	0 2½	2.2%	1.1%
£200	0 5½	0 2½	2.3%	1.1%
£300	0 8½	0 3½	3.4%	1.4%
£1,000	1 3½	0 4	6.9%	1.7%
£2,000	2 1½	0 7½	10.7%	3.2%
£5,000	3 7½	1 3½	18%	6.4%
£10,000	4 8	1 9½	23.3%	8.0%
£20,000	5 0½	2 3	27.8%	11.3%
£50,000	7 11½	2 7½	39.9%	13.2%

### V. Duty on Gifts

The death duties, if alone, can be easily evaded by liberal gifts during the lifetime of the deceased.<sup>3</sup> One of the

1 According to the opinion of the Federal Court, the original Act of 1935 did not empower the Central Government to impose estate duties. The Act was, thereupon, so amended as to give this power to the Centre in respect of non-agricultural property. Despairing of the Provincial Governments to fall into line, the Government of India decided to start with an estate duty on non-agricultural property. This would mean a further differentiation in favour of landlords (the first being exemption of agricultural incomes from income-tax).

2 Report of the Committee on National Debt and Taxation, pp. 81 and 82. The later figures given by Shirras and Rostas are not taken as in their method of calculating the burden of death duties the income tax burden is also reflected. *Vide Chap. IX.*

3 "That any revenues were forthcoming is presumably attributable to untimely deaths, to utter distrust of beneficiaries, or to mere disregard of their interests".—Simons, p. 131.

largest estates in the world was given away in U.S.A. as a gift, when no gift tax was in force in that country.<sup>1</sup> A gift tax was enforced in U.S.A. in 1924, repealed in 1926 and restored in the 1932 Act. Since then, the tax on gifts has continued to be a part of the federal tax system. The gift tax in 1935 began with 1½ per cent upon the amount of "net gifts"<sup>2</sup> not exceeding \$10,000, and increased up to 52½ per cent levied on net gifts in excess of 50 million dollars.<sup>3</sup> Great Britain has no tax on gifts; some stringent provisions, however, have been inserted to prevent a wide-scale evasion. All gifts made by the deceased at any time, where bona fide exclusive possession of the gift is not taken by the donee, are considered as a part of the estate left on death; gifts made in contemplation of death and only absolute in event of death are also liable to death duties. Gifts made three years before death except in marriage settlement, or gifts for public or charitable purposes made less than one year before death have to pay death duties, unless they are parts of the normal expenditure of the deceased, or do not exceed £100 per donee. These provisions only guard against *mala fide* transfers and against transfers made during three years before death. The value of this time limit as a provision against evasion is greatly restricted by the exemption of gifts made in consideration of marriage. In any case bona fide gifts made earlier than three years before death escape the tax. Since the richer a person, the greater his power to give gifts during lifetime, this gravely tones down the progression of death duties. Moreover, those who die young and without any warning from death have to bear a greater burden than others who live upto a ripe old age, or have warnings of death dinned into their ears in a hundred ways. Though the necessity of maintaining old family estates and dignity in England acts as a brake on the ten-

1 Green, p. 222.

2 Net gifts mean the amount of gifts less deductions allowed by way of exemptions under the Gift Act. The system of exemptions is peculiar. There is not only an exemption upto a certain amount of total gifts or an exemption upto a certain amount of gifts given to one individual, but both the exemptions are combined.

3 Green, pp. 223-224.

dency to evade the death duties through liberal gifts in lifetime, it has been estimated that about one-fourth of property in U.K. is transferred by way of gifts.<sup>1</sup>

India, also, if it is to have a successful system of death duties will have to evolve a taxation on gifts.<sup>2</sup> At present, even as in Great Britain the only gifts which have to give taxes, rather registration fees, are those, which are registered—mostly immovable property. But if death duties are made a part of our tax system, we will have to evolve, unlike Great Britain, a duty on gifts on the U.S.A., model. The rates of the tax will be largely determined by those of death duties. They must not be much lower than those of death duties; at the same time they need not be as high, because there is the natural "reluctance of property owners to pass with their own, even to their dearest and nearest."<sup>3</sup> Moreover, the tendency to divide one's property during one's lifetime needs encouragement, for that brings wealth to heirs at an earlier age, when they need it more and can use it better.<sup>4</sup>

1 Wedgwood—*The Economics of Inheritance*, p. 236. Strangely enough the author says, "many conveyancing solicitors will probably consider this as a serious understatement, since the evasion of the Death Duties seems now one of their principal functions".

2 Being content with the English Tax Laws, the Legal Adviser to the Indian Taxation Enquiry Committee did not argue for this.

3 Taussig—*Principles of Economics*, Vol. II, p. 561.

4 Cf. "There could be no better eugenic or sociological institution than a kind of moving annuity which should pass from generation to generation, not at the death of each person, but from him to his children at a point when his personal need for it has become less, and when his son's need for it has become the greatest". Stamp, *The Eco. Journal*, 1926, p. 372.

## CHAPTER V

### TAXATION OF BUSINESS

In most of the civilized countries, it is a practice to levy along with the personal income taxes that we have discussed some tax or taxes on the net income or capital of businesses. Among the businesses, the companies or the corporations have attracted special attention.<sup>1</sup> Since in most of the countries, a corporation tax is the most usual business tax, we shall deal at length with this particular form of taxation. We propose, however, to omit from our consideration the fees levied in many countries at the time of registration of companies, as these fees partake of an entirely different character, are small in amount, and are levied once during the lifetime of the company. We shall also not take into account the small annual license charges which businesses have to give in some countries.

#### I. Taxation of Corporations

##### Benefit Theory

The most cogent reasoning urged for taxation of corporations has been based on the benefit theory. A corporation is endowed by the State with a great privilege, which enables it to collect and command large amounts of capital for business. An agglomeration of a great number of persons, who are in many cases unknown to each other and bound by very loose ties, is given a "shape and a name" by the State. The shareholders of a corporation, unlike the partners of a firm, have no fear of losing their entire savings. If the worst comes to the worst, they lose the amount

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<sup>1</sup> We are not, it must be remembered, referring here to the British practice followed also in India of collection at the source, where the companies are only utilized as a means of facilitating collection. In these cases, while an impersonal tax rate is levied in the beginning, by a system of refunds and further collections, appropriate adjustments are made in the tax rate to suit the income of the earner. The companies, in this case, are only acting as the collecting agents.

invested in the company shares. This limited liability of the shareholders imparts to the shares an easy transferability which reduces the risk still further, and confers a greatly valued liquidity on the investments in corporations. It also enables a prospect of a comparatively safe sleeping partnership. These facilities enable corporations to obtain much greater amounts of capital than other partnerships. Since money obeys the law of increasing returns, with this greater capital in their hands they earn greater profits. It is only reasonable that the State should take away a great part of these extra profits.

### Objections to the Benefit Theory

(i) **Advantage of Corporations General:** This position has been strongly assailed from two sides. It is conceded that incorporation confers a number of valuable rights on the corporations. But, it is argued that the sound principles of taxation demand that a benefit be made the ground for taxation, only if it is special, and if its advantages are confined to a class which there is no need to subsidize. Incorporation, under modern conditions, is the *sine qua non* of general economic progress. The State, whose sole concern must be the maximization of people's welfare, gives this privilege to the corporations because of their general contribution to national prosperity. Moreover, to-day the advantages of incorporation are open to all, who want to avail themselves of it and who are prepared to abide by its conditions. No longer we have the era of special charters granted by sovereigns. Incorporation is, therefore, no more a special benefit.<sup>1</sup>

While admitting the great benefits of incorporation to the whole community, we must point out that the benefit theory of taxation, which the objectors presume, is faulty.

1 Cf. "As a practical matter, in a capitalist society, no state can refrain from sanctioning or even fostering the most advantageous, if often predatory form of business organization known as the corporation. Nor can or should it refuse this privilege to all qualified applicants on equal terms. General incorporation laws have displaced the special charters granted by the sovereign in exchange for monopoly royalties, or by the legislature under political pressure. Incorporation available to all is not a special privilege." —Jensen, *Government Finance*, p. 342.

For a tax to be levied on the grounds of special benefit, it is not essential that the activity, in course of which the benefit is obtained, should not redound to general benefit. It often happens, that the State, in the performance of its duties, has to take steps or measures, which, while certainly in general interests, also incidentally confer a valuable benefit on certain groups or classes of people. In such cases, it has been considered as just and equitable for the State to take from the groups and classes so benefited any sum not exceeding the value of the benefit. If the State builds a railway (obviously in general interests), and as a result the prices of lands adjacent to the railway line go up, it is perfectly justified in taxing this rise in value, this unearned increment, upto 100 per cent. If the State finds, that in the interests of its subjects, growth of corporations and companies is essential and therefore grants the privilege of incorporation, there is no reason why it should be debarred from taxing the greater earning power it thereby confers on companies. The advantages of incorporation and of holding a share of an incorporated concern may be open to all very much like the Ritz Hotel, but not all can avail themselves of them, and the extent of the benefit widely varies, so that the benefits do remain special in practice.

**(ii) Corporations not Individuals:** Another argument advocated with a show of logic has been that corporations, after all, have a fictitious existence. They are only legal persons. They have no wants, no desires of varying intensity and urgency. The only persons, who have these, are their shareholders, and in deciding the justice of a corporation tax, its effect on the shareholders should be the guiding consideration. So considered, a corporation tax is indefensible. Even in its least objectionable form, viz., when it is proportional, and on the simplest supposition that all profits are distributed, it creates a grave injustice. A shareholder, whose total income is under the exemption level, will have to pay some tax. In other cases also, unless we have also a proportional income tax at the same rate as the

corporation tax, injustices will occur. The method of fixing an exemption limit for the corporations avails little,<sup>1</sup> for there is no relation between the size of a corporation and the total individual incomes of its shareholders. Big corporations may have, and very big corporations have, many shareholders with a total income below the exemption limit. Small corporations, on the other hand, have big shareholders, whose total incomes are so great as to be taxable at the maximum rate. A tax on corporations, thus, cannot be adjusted to the ability of the shareholders, and would have, therefore, to be given up.

This objection entirely misses the point in the argument for a corporation tax, that we have urged before. A tax according to individual ability cannot be the "be-all and end-all" of a just tax policy. While the personal ability criterion is the most widely applicable test of justice, there are occasions, when, as we have seen in the first chapter, the cost-of-service theory or the give-and-take theory serves the purpose of justice more admirably. A tax on corporations falls in the second category. Since corporations are given special advantages by the State, there is no reason why the State should not take a part, or the whole, of the value of these by way of taxation. This involves no injustice to shareholders, since the privileges of incorporation add to the profitability of the shares they hold.

### Other Arguments for a Corporation Tax

In addition to the benefit principle there is also often another ground on which the corporation tax is defended. The partners of other competitive forms of business organizations have to pay a tax not only on their shares of distributed profits, but also on those of undistributed profits which they utilize in the expansion, or for the stabilization, of their business. The absence of a similar tax in case of shareholders is manifestly unjust. Since no other remedy

<sup>1</sup> India had such an exemption system upto 1929, though the Indian Taxation Enquiry Committee had condemned it in strong terms. Report, para 251.

to bring about perfect equity between the two forms exists, it is pleaded that a rough and ready sort of justice should be achieved by some tax on corporations.<sup>1</sup>

Leaving untaxed the shareholders' shares in the reserves of the company not only lets go tax-free the sums needed in the furtherance of business (an inequitable process, but leading to good social results), but it provides also an easy and valuable means of evasion to the rich tax-payers, who form a private company and allow the profits to go on accumulating in the reserve fund, drawing only by way of dividends what they need, and sometimes not even these, for they can secure loans from the company. Stringent provisions are made to cope with this problem of evasion, and great powers are given to tax officials; but owing to the difficulty of deciding the reasonable needs of the business, and due to the great possibilities of manipulating accounts, the problem remains unsolved.<sup>2</sup> A tax on incorporation, it is contended, will serve to weaken the incentive to evasion.

While recognizing the inequity of the modern tax system in its treatment of the two main forms of business organization, it is hard to see how a corporation tax can remedy this. It is true that in modern economic life in certain spheres there is a strong competition between private firms and companies; and it is unfair of the State to show special favours to the companies by letting the shareholders' shares in their reserves go tax-free.<sup>3</sup> But this only means that some scheme of righting this wrong is called for. Simply because no practical schemes have been

1 "Its (of the corporation profits tax) justification lies partly in the fact that companies derive certain advantages and enjoy certain privileges as the result of the incorporation, and partly in the fact that that portion of the profits of companies, which is not distributed as dividends, but is placed to reserve, escapes assessment to super-tax". *Ibid*, para 251. See also Chamberlain's speech in presenting 1920-21 budget quoted in Haig—The Taxation of Excess Profits in Great Britain, p. 167.

2 For the provisions in U. S. A. and U. K. and their failure, see Simons, pp. 189-190.

3 The attitude of the Colwyn Committee is unhelpful on this point. "A comparison between the public company and the big individual trader is in many respects a comparison between uniques and must not be pressed too far". Report, para 390.

evolved so far, levying a corporation tax which cannot claim even to remove roughly the inequity in the present situation means only the addition of a new wrong. Similarly, the problem of evasion, to be successfully tackled, needs an exact knowledge of the reserves kept, and essential to be kept, in various kinds of business;<sup>1</sup> no quack medicine like a corporation tax can cure this.<sup>2</sup>

## II. Forms and Rates of Corporation Taxes

We have come to the conclusion that there is nothing wrong in charging a corporation by way of a business tax on it because of the special benefits the State confers on it. The amount and the basis of the tax, that ought to be imposed, are in theory easily inferred from this. The tax ought to be in proportion to the extra ability to earn acquired by favour of the State. In practice, however, it is very hard to evolve any suitable index of the extra earning capacity. In the case of individuals, we have regarded income as the criterion *par excellence* of ability. With regard to corporations, however, capital is often urged as a more suitable criterion. Many other queer combinations are suggested and have been practised.<sup>3</sup> To decide the scale of rates to be followed is equally difficult. Should the tax be regressive, proportional, or progressive? Since the tax is a benefit tax, no sure test is available as in case of a tax based on ability theory. A proportional<sup>4</sup> tax, however, we feel, will be proper.<sup>5</sup>

Let us examine some of the more prominent corporation taxes imposed in various countries.

1 Even then, one can only proceed on the assumption that a uniform level of reserves ought to be kept in all firms in the same branch of business.

2 We shall discuss this problem at fuller length when discussing the tax on undistributed profits, for that, we feel, is the only tax, for whose imposition the inequity of the present tax system, and the possibilities of evasion it offers, can be urged as a plausible argument.

3 Seligman enumerates no less than thirteen important bases of the tax in U. S. A. *Vide Essays in Taxation*, pp. 218-219.

4 Somehow, benefit theory has usually been believed to lead to proportional taxation. See Chap. I.

5 Cf. "The application of the progressive principle to corporations is therefore of dubious expediency".—Seligman, *Progressive Taxation in Theory and Practice*, p. 318.

### A—Tax on Capital

Since the special benefit that a company gets enables it to get more capital, the capital of a company is often considered to be a good criterion to measure the special earning capacity. Such a tax, however, is not successful, because the task of computing capital, as the U.S.A. experience shows,<sup>1</sup> is greatly difficult. Various devices as over-capitalization, watering of stocks, etc. make the task of finding out invested capital from the present book-entries impossible. If we insist on a proper book-keeping from now onwards, in future we may have a satisfactory way of ascertaining the invested capital, but to-day we have none.

### B—Tax on Income

An equally justifiable and administratively more feasible tax is the tax on corporation income. Since benefit is better taxed, only when, and to the extent, it realizes itself in greater income, this tax is better than the one on capital. It also avoids the disastrous consequences that an annual tax on capital may produce. Many companies with large capitals make no profits during some years. To exact from them during such time a tax, which, however moderate the rate, will amount to thousands of rupees, may mean their liquidation.<sup>2</sup> Moreover, corporation income, though a difficult thing to arrive at, is more easily worked out than its capital. A tax on it, therefore, has been greatly favoured. In Great Britain, however, the tax has been looked down upon. In 1920 a Corporation Profits Tax at a uniform rate of 5 per cent on company profits was levied,

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1 The so-called "capital stock tax" of U. S. A. is no capital tax for under it the companies are allowed to declare themselves the value of their capital.

2 One is reminded of the State Commercial Railways in India, on which according to the Railway Convention of 1924, a capital tax of 1 per cent was levied. The War Transport Member in his 1943-44 Railway Budget Speech was very severe in his criticism on this matter. "It is not unfair to say that the failure to adopt a sound financial policy had brought railways in a most perilous position, from which they have only been rescued, for the present, by the abnormal condition of a world war". Para 21.

but was soon repealed.<sup>1</sup> So far, no such tax has been revived.<sup>2</sup>

### Scale of the Tax

We have argued before that as the special ability resulting from benefits of incorporation cannot even be roughly measured, it is best not to apply the progressive principle to a tax on corporation profits. Most of the countries have realized the wisdom of this rule, and levied only proportional taxes. U.S.A., however, has since 1935 flung this caution to the winds, and embarked on the progression principle even in company taxation. The progression, however, is too small—from 12½ per cent to 18 per cent<sup>3</sup>—to create any great effect, and thus to put to test a crucial principle.<sup>4</sup>

In India, corporations have been taxed for many years. By a great anomaly, this had been considered as a part and parcel of the income tax. This wrong analogy so impressed itself on the mind of the Government that even as in the case of individuals, an exemption level was provided for in case of companies. The anomaly is fortunately removed.

1 For a characteristic British comment, see "It was a poor affair, uneven in its incidence and easily evaded."—Hicks, Hicks and Rostas, *The Taxation of War Wealth*, p. 90.

2 The supreme need for more revenue has once again compelled the British to have under the grand name of National Defence Contribution a business profits tax. Under it, both the incorporated and unincorporated firms are taxed on their profits. On corporations a 5 per cent tax is levied, on unincorporated concerns 4 per cent. The purpose as well as the justification of the Act are, however, very different. The idea is not to tax the special ability of corporations, for in that case the unincorporated bodies would have been left untaxed, but only to tax the greater profits that all businesses are likely to make because of the feverish war preparations. For this purpose, public utilities, whose rates are regulated, and, which can, therefore, make no extra war profits, are exempted. With the passing of the E. P. T., the N. D. C. Act, though existing side by side, occupies in practice an unimportant place being levied only where profits are not liable to E. P. T. So much, because there seems to be a strange misunderstanding about N. D. C. It has been described as "another version of C. P. T."—*Taxation of War Wealth*, p. 90; see also Green, p. 59.

3 Revenue Act of 1939—an article in the *American Economic Review*, 1939, p. 703.

4 Strangely enough, the income from corporations was exempted upto 1936 from personal income-tax in U. S. A. as if to compensate the shareholders for the corporation tax.—See Green, p. 59.

now. By the 1939 Finance Act, a super-tax of 1 anna in the rupee was levied on all corporation profits. With the changes in the rates of the income tax, this tax also has been increased. From April 1944, the tax on corporation incomes has been raised to 3 annas. A concession is provided for in the case of undistributed and such other profits as are distributed in the payment of dividends bearing a fixed rate of interest. In both these cases, the tax is only 2 annas.

### Incidence of the Tax

A tax on corporation profits can achieve its desired aim, only if its incidence is on the shareholders. If it is shifted to the buyers of the goods or services that the corporations produce or render, the tax will be a type of a sales tax at varying rates on different types of goods. Usually, however, no such possibility can arise when a tax on corporations is levied according to their net profits. The possibilities of passive investment and limited liability are open only in companies, so that no moderate tax is likely to lead to transfer of capital from companies to private businesses. Under modern conditions, private businesses and companies form non-competing groups to a great extent. There are some private companies, which are companies only in form, and whose owners can change them into private firms without much trouble to themselves. Nonetheless, no such course is likely to be followed until a heavy tax is levied, for such persons gain more by our system of not taxing the undistributed profits of the company at the maximum rates than they are likely to lose because of the profits tax. If, however, the tax rate be very high, the tax is likely to be partly capitalized and will rest on old shareholders, and partly, since investment in private businesses will become more attractive, will be passed on to consumers of those goods and services where corporations play a dominating role.

In cases, however, where the prices are controlled by the State and where corporations play a predominant part as in the case of public utilities, there is a likelihood of

even a light tax being shifted to consumers.<sup>1</sup> In the fixation of these rates, as is well-known, the reasonable profits that the shareholders must get are taken into account. A tax on corporation profits, unless it changes the concept of "reasonable" in the minds of the rate-fixing commission, may mean a higher charge for consumers. Public utility concerns were, on this ground, exempted from the British Corporation Tax of 1920.<sup>2</sup>

### C—Undistributed Profits Tax

#### A Method to Remove Two Major Inequities

We have seen the inequity that prevails in our income tax system between partnerships and companies, and the possibilities it creates of a wide-scale evasion. An undistributed profits tax, it is pleaded, is the best weapon to remove these two "major inequalities."<sup>3</sup>

We have already pointed out where the great inequity exactly lies. In order to remedy this inequity, only two courses are possible:—(a) to treat private businesses in the same manner as companies. Even as with a company, in the case of a private business, we ought not to tax that part of business profits, which is utilized for its growth, expansion or stabilization. Such an arrangement, however, would be administratively impracticable. Moreover, once this demand is conceded, it is hard to withhold a similar demand with regard to professionals, multiplying still further the administrative difficulties;<sup>4</sup> (b) to treat companies as private businesses. Undistributed profits must be treated as if they had been distributed as dividends among the shareholders. This can only be done, if the rights of the various kinds of shareholders are definite, or still more easily if we had only some standard contracts between the company and shareholders. As it is, however, we have a

1 Lutz—*Public Finance*, p. 403.

2 Shirras, p. 596.

3 President Roosevelt's tax message in 1936, quoted in 'Revenue Act of 1936'—*The American Economic Review*, 1936, p. 467.

4 'Report of the Committee on National Debt and Taxation,' paras 1017 and 1018.

bewildering variety of shares, and to assign the undistributed profits of a company among the holders of these on any rational basis is an impossible task.<sup>1</sup>

These two methods of bringing about perfect equity being ruled out, a tax on undistributed profits is advanced as a rough and ready method of having some sort of equity. It is hard to see, how this method can achieve the end.<sup>2</sup> The amount of this tax bears no necessary relation to that which would have been paid, if the entire profits were distributed. Moreover, the need to have reserves varies from industry to industry, and from firm to firm within the same industry. Small corporations need more reserves than big corporations, for they can depend less on outside credit.<sup>3</sup> Growing corporations cannot afford to distribute the same part of their profits as mature ones, because they need funds for their expansion; corporations dealing in consumers' goods can rest content with less reserves than those dealing in construction goods for the latter are liable to greater fluctuations; for the same reason, companies producing necessities may be satisfied with less reserves than companies dealing in luxuries. Since it is not possible to make an allowance for the varying needs of all these, a tax on reserves will hit some companies harder than others.

The claim of an undistributed profits tax to deal with the problem of evasion is equally untenable. It may be that in a few marginal cases the tax may prove the deciding factor, the last straw on the camel's back, and may prevent the accumulation of an excessive reserve fund. In the great majority of cases, however, though the advantages of a private company as a mode of evasion will be reduced, they will remain substantial. Most of the persons, who resort to the device of private companies, will be

1 See Simons, pp. 189-194.

2 President Roosevelt had a very queer idea of equity. In his tax message, he pleaded that "the rate on undistributed corporate income should be so graduated and so fixed as to yield approximately the same revenues as would be yielded if corporate profits were distributed and taxed in the hands of stockholders."—*The American Economic Review*, 1936, p. 467.

3 Buehler—*'The Undistributed Profits Tax'*, p. 96. This is a result entirely at variance with Roosevelt's desire to help small corporations.

otherwise liable at the maximum income tax and super tax rates. The tax on undistributed profits cannot be so heavy, for otherwise many big companies, which have not the slightest intention to pile up reserves to evade income tax, will have to pay penal taxes on undistributed profits. Most of them will be forced either to distribute a major part of their earnings and have little reserves,<sup>1</sup> or to put forth superhuman efforts to keep reserves at the necessary level. There can be no doubt as to what the majority will do under such circumstances.

While, theoretically, this prospect of almost all the corporation profits being distributed may sound attractive as an ideal solution, its practical results will prove disastrous. The sources of corporation finance are entirely different from those of private businesses. Unlike the latter, the corporations cannot depend on the active interest of the owners for their finance. If the shareholders were given all the profits, there is little likelihood of their being re-invested in the companies, when they are needed. In bad times, the passive owners, thanks to their limited liability, will not like to invest more. Corporations can tap other avenues of money like public bonds, loans, etc., more easily than private businesses. But these bring with them commitments of interest and some of them are liable to be recalled any moment; the best way to get them on easy terms, and to a sufficient extent, is the piling up of a good reserve fund. The reserves alone can enable a company to tide over bad years, to have a stable dividend policy, and to embark on an expansion scheme when the times are propitious, without incurring any extra cost. To dry up this great source of strength is to precipitate a disaster for the companies and to cause a general setback to economic progress. None can look upon such results with equanimity. A prohibitive tax on undistributed company profits must, therefore, be ruled out. A tax lighter than this can hardly be expected to prove an effective check on evasion.

<sup>1</sup> President Roosevelt and certain other American Economists believing in the "under-consumption" theory of depression wanted some such result. The position of dependence on the State in which the companies would then be put in times of difficulty was, to them, an additional attraction.

### Effects on Shareholders

Unlike a net income tax on corporations, a tax on undistributed profits cannot be justified on the grounds of special benefit conferred. Its effects, therefore, on shareholders must be considered. There is no relation between the wealth of the shareholders, and the proportion of profits that their company distributes. The tax, therefore, will mean a great inequity among the shareholders.<sup>1</sup>

### Practice in Different Countries

In spite of the untenability of arguments for it, the tax on undistributed profits prevails in a number of countries. In Great Britain the undistributed profits of the company have been taxed at the standard income tax rate for the last so many years. The standard rate of tax is laid down in the Annual Finance Acts. Just before the war, it was 5s. 6d. per £ i.e. 27.5 per cent—certainly a high rate; at present it is 10s. i.e., 50 per cent. In India, a tax is levied on undistributed profits of the company at the maximum income tax (excluding super tax) rate laid down in the annual Finance Acts. For the year 1939-40, it was fixed at 2 annas 6 pies per rupee, i.e., 15.625 per cent; for the year 1945-46, it is fixed at 4 annas 9 pies per rupee.<sup>2</sup> In U.S.A., undistributed profits were taxed since 1936. Unlike other countries, the rate of the tax increased as the percentage of undistributed profits to total income went on increasing. The rates were as follows:

1 The attitude of the Colwyn Committee to this problem is queer. "As regards the first (i.e., equity between various shareholders) it has only to be remarked that the company reserve is composed of the involuntary savings of shareholders with incomes of varying size..... But the man who is escaping Super Tax on his share is unaware of any benefit, and the man with an income not liable to Income Tax is not conscious of any hardships."—para 398. Consciousness of the inequity suffered is no consideration in the equity of a tax.

2. Both in Great Britain and India, the method of taxing undistributed profits is peculiar. All the company profits are formally taxed at the "standard" or the "maximum" rate. The company deducts this rate from the dividends it distributes to its shareholders. By a system of refunds and "extra charges" appropriate individual rates are levied on distributed profits. The "standard" or the "maximum" rate, thus, applies only to undistributed profits.

7%	on the portion of the undis- tributed net income in excess of			10% of the adjusted net income
12%	do	do	do	between 10—20%
17%	do	do	do	between 20—40%
22%	do	do	do	between 40—60%
27%	do	do	do	in excess of 60% of the adjusted net income

These rates at the lower stages were moderate compared both to the Indian or the British tax. Even in a case, where no profits were distributed, the tax would only amount to 20.5 per cent. In the ordinary case, where at most 60 per cent of the net profits was kept as reserves, the tax amounted to less than 16.2 per cent. The great opposition that this tax aroused seems to have been due to its novelty, its avowedly regulatory purpose, and its being a part of a complicated net-work of a corporation tax system, for each component of which much could be said, but whose combined weight was bound to prove oppressive. The progressive rate of this tax intensified the inequities between corporations that a tax on undistributed profits was bound to produce. As a result of this opposition, the tax was considerably reduced in 1938, and entirely removed in 1939.

The inequities that we have pointed out will result only in so far as the incidence of the tax is on the companies. In general, that is so because a tax on undistributed profits is a tax on a part of the net income, which does not enter into prices. But sometimes the varying effects of the tax on different companies set forces in motion, which may cause the tax to be shifted to the consumers. A tax on undistributed profits reduces the attractiveness of investment in those companies, which stand in need of big reserves. Thus, it may bring about a transfer of capital from industries needing big reserves to those in need of less. The possibilities of capitalization of the tax, so far as old shareholders are concerned, and a shifting of the tax to the consumers, so far as new capital is needed, exist in such cases. As long as the tax is not very heavy, this will not be a powerful factor.

## D—Excess Profits Tax

### (i) During Peacetime

In addition to the three corporation taxes that we have seen so far, we have in U.S.A. an excess profits tax on corporations. Modern business conditions facilitate the growth of large firms having a great control over market supply. This results in more than competitive profits to them, in "excess profits" as they are called. The State must take away as much of these, as it can. A tax on excess profits ideally ought to extend to all fields; corporations as well as private businesses ought to be embraced by the tax. But usually monopoly or quasi-monopoly is only possible in case of business units commanding a large amount of capital. Such units will mostly be corporations. Moreover, the task of administering an excess profits tax is much easier in their case. The excess profits tax is, therefore, confined on practical grounds to corporations only.

### Objections to the Tax

So defended, the excess profits tax is open to a number of objections, most of which turn round the concept of "excess" profits and "normal" profits. What are the "normal" profits of a business or firm? Theoretically speaking, they are profits which would accrue in a condition of perfect competition. But in practice, it is hard to find these out. We have, certainly, a number of industries where fairly good competition prevails; but we cannot work from the profits of these to normal profits for other industries. The term "normal profits" covers many economic concepts hard to unravel. The reward of risk-taking is included in this term. Risk is a vital factor in production, so that we dare not take the risk of eating into its reward. The tax may, moreover, mean a penalty on efficiency and inventiveness. Though high profits are often the result of social environment, they may also be the result of individual ability and business genius. To tax them without discrimination is to destroy, or at least seriously diminish, one

of the great sources of economic progress.<sup>1</sup> To discriminate between high profits due to these two different reasons is very difficult.

The force of these arguments has proved conclusive in preventing many countries from having any excess profits duty in peacetime. U.S.A. has, however, from 1933, an excess profits duty in force. The duty at first was levied at a 5 per cent flat rate on all amounts in excess of 12½ per cent of the adjusted declared value of the capital stock.<sup>2</sup> In 1935, however, the tax was made progressive—6 per cent on net income in excess of 10 per cent and not in excess of 15 per cent, and 12 per cent on the net income in excess of the 15 per cent of adjusted declared value.<sup>3</sup> These rates are quite moderate, and will do little harm from the viewpoint of their effects either on risk-taking or on individual efficiency. If coupled as in case of war-profits taxes, with a provision giving power to some body to raise "normal profits" in exceptional cases, the statute may find adherents in other countries.

### **Administrative Difficulties**

Even when all adjustments have been made to make the peacetime excess profits tax unobjectionable, a great administrative difficulty remains. When discussing a tax on corporations according to their share capital, we saw that the great difficulties confronting such an attempt had made U.S.A. give up the tax. Here, we have to calculate not only the share capital, but the whole working and fixed capital, which is a more difficult task. The Americans have devised an ingenuous way of dealing with this difficulty. In U.S.A., a capital stock tax is charged on capital as declared by the officers of the company for the purpose of

1 Cf. "Something can be said for a graduated tax on income; something can even be said for a graduated tax on capital; but it is so difficult to say anything in defence of a tax which is graduated on the varying percentage which income bears to capital. To penalise enterprise and ingenuity in a way that is not accomplished by a tax on either income or capital—that is the unique distinction of the law."—Seligman, "War Revenue Act" in the 'Political Science Quarterly,' March 1918, p. 29.

2 Green, p. 97.

3 Green, p. 100.

determining the excess profits tax. The combination of these two acts puts the taxpayer on the horns of a dilemma. If he declares his capital too low, he will have to pay an unduly high excess profits tax; if too high, he will have to pay an unnecessarily high capital stock tax. For any one year, of course, the choice is easy. A little arithmetic will show the company the most favourable combination, and it can declare its capital accordingly. But over a number of years, no such calculation is possible. The rate of the two duties may vary any year, upsetting previous calculations; the relation of profits to the declared stock capital is bound to vary from year to year. This dilemma, it is hoped, will make the taxpayer speak the truth. The exact strength of this procedure depends on the length of time, for which a declaration regarding capital stock is made binding. If the corporation officials are allowed to make different declarations every year, the procedure loses all sense. The U.S.A. Government so far has not appreciated this point. By the Act of 1933 the stock first declared in that year was to be taken to be the stock for subsequent years, the only changes permissible being due to the actual increase of, or decrease in, capital. In 1936 an option was given to the companies to declare their capital afresh. In 1938, when the capital stock tax was lowered from 0.14 per cent to 0.1 per cent, a fresh opportunity was again given, the declaration being binding for three years.<sup>1</sup> Thus, so far, U.S.A. has given opportunities for fresh declaration, whenever new rates were imposed. The results have not been happy. Much greater sums are collected from the capital stock tax than from the excess profits tax.<sup>2</sup> The companies have found it more profitable to declare the capital stock higher.

#### (ii) During Wartime

The public clamour and the State need for taxation of excess profits become especially great in wartimes. The

1 *Vide* Green, pp. 99-100.

2 In 1934 and 1935 while \$2.6 millions and \$6.6 millions were collected from excess profits tax, more than \$80 millions and \$91 millions were collected from the capital stock tax—Green, p. 98.

demand for armaments and war goods, the civilian demands of the vast number of soldiers, the great changes in foreign trade due to cessation of imports from and exports to enemy countries, shipping difficulties and gain or loss of markets in neutral countries, the shiftings of population, the destruction of property and goods by bombardment—all these war phenomena mean a great change in the direction of production. These, coupled with the failure of the government to meet war expenses out of taxation and borrowing, and with the fact that these processes continue throughout the war, enable many persons, who find their skill, capital equipment or goods in greater demand, to make fortunes. These extra profits are not the result of any intelligence or foresight on their part, and therefore are mere windfalls which may well be taxed cent per cent. Other circumstances are propitious for such a tax. The labourers do not wish that out of their sweat their owners should prosper; the fighting forces do not relish some manufacturers getting prosperous out of events that involve them in deadly combats; the other traders and manufacturers, who find their goods in less demand as a result of the war, join hands. The cry to let no person make a fortune out of a national calamity goes out. The Government, in great need of revenues and in greater need of the sympathy of these people, has to devise some tax on war profits.<sup>1</sup>

But no amount of propitious political circumstances, no public clamour, and no government anxiety could make an excess profits tax possible, unless it were administratively workable. We have seen the great difficulties that encounter an excess profits tax during peacetime. Fortunately, most of these difficulties are rendered easily surmountable in war conditions. The concept of "normal" profits is easily defined in such times. All profits due to war are considered to be "excess" profits; and usually, all profits during war are supposed to be due to war. This supposition is, in the main, true to facts, for all ordinary forces of promotion and expansion are in suspense during wartime.

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1 Cf. Haig, pp. 3-5.

There are, however, exceptional cases for which relief provisions have to be made

### Standard Period

It is easy to visualise theoretically the concept of war profits and of profits during peacetime. But the task of laying down a practical method of calculation is difficult. Normal peacetime profits are usually defined in terms of profits made during the past few years before the war—profits made in the "standard period." The choice of the year or years, which should be taken as "standard period," becomes a greatly controversial task. Two imperative rules must be observed in this choice: (i) Since we wish to tax excess profits during the war, the standard period must be as near the war as possible, while being sufficiently remote from it not to be affected by the war preparations. It was, therefore, that the refusal of the Indian Government to include the choice of the year 1938-39 among the standard period was the prelude to a great business agitation. The government finally allowed this year to be included among the standard period, but it was not a year which could be chosen alone. Contradictory as it may seem, the British law, which does not allow any year after June 1937 to be taken individually as the standard period and no year later than December 1937 to be counted in the standard period, was dictated by the same considerations, for the British Government had long ago embarked on vast rearmament expenditures (ii) As profits in a single pre-war year may not reflect normal profits, an average of two to three years is preferable as a standard period. Since depression affects different industries differently and in different years, and since also the history of individual firms widely differs, a system permitting sufficient elasticity through a wide choice of the "standard period" is highly desirable. This requirement has been usually satisfied in all countries. In India, for example, under the present excess profits tax any of the following periods may be selected: (a) the year 1935-36, (b) the year 1936-37, (c) the years 1935-36 and 1937-38. (d) the years 1936-37 and 1937-

38, and (e) 1937-38 and 1938-39.<sup>1</sup> This wide choice obviates the necessity of laying down different periods for different industries.

### Provisions for Hard Cases

The choice given, however wide, involves difficulties to certain industries or firms. It may happen that the standard period laid down was one of depression or misfortune for them; or they might have during that period made investments mainly with a view to the future profits. Such hard cases have to be specially provided for. Various sorts of provisions are inserted to give the necessary relief in such cases:

(a) **Wider Choice of a Standard Period:** Wider choice of a standard period is given to firms or industries, which can prove themselves to be specially unfortunate in the normal period. The Excess Profits Duty in U.K. in the last war laid down any two of the three pre-war trade years as the standard period in normal cases, but where firms or industries could show that their profits in the three pre-war years were less by 25 per cent than those of the six pre-war years, they were allowed to choose any four out of the six pre-war trade years as their "standard period."<sup>2</sup>

(b) **Raising of Standard Profits:** Discretion may be given to certain bodies to raise standard profits in those cases where special reasons can be assigned. During the last war, the Board of Referees in England were empowered to increase the profit percentage in case of a "class of trade or business,"<sup>3</sup> and cases are on record, when they declared 29½ per cent as standard profits. Under the present E.P.T. in Great Britain, a similar option has been given. If satisfied that in the standard period the rate of the profit or business volume of any firm was less than might have been reasonably expected, the Board of Referees may raise the standard profits to the level they think

1 Excess Profits Tax Act, 1940, Sec. 6 (2).

2 'The Taxation of War Wealth,' p. 73.

3 Haig, p. 125; for the list of such cases, see pp. 131-136. For an account of how the discretion worked, see Stamp—"Taxation of Profits During the War," pp. 170-178.

just. In case of companies, however, their power to increase standard profits is limited; they cannot raise the amount beyond that necessary to provide the fixed interest on paid-up share capital, and 6 per cent per annum on paid-up share capital where no interest has been fixed, except in the case where they are satisfied that there is some specific cause peculiar to the trade or business to grant a greater amount.<sup>1</sup> In India, we have a similar clause in the present Excess Profits Tax. Section 6 (3) of the Act gives power to the Board of Referees to raise the amounts of standard profits to such limits as they think just, if they are satisfied that during the standard period the profits of the business were less than might have been reasonably expected; but they have no power to grant an increase higher than the statutory percentage<sup>2</sup> on average capital employed, except when convinced that such an amount should be allowed owing to some specific cause peculiar to the business. It will be seen that whereas the Board's power to raise standard profits is limited in England only in case of companies, in case of India it is circumscribed in all circumstances. In case of India, besides an application to the Board through the Excess Profits Tax Officer, a second appeal lies to the Central Board of Revenue, whose powers are similarly circumscribed.<sup>3</sup> By way of illustrations rather than exhaustion, certain hard cases are specially mentioned in the Act. Businesses of pioneer nature, i.e. those concerned with an industrial process not tried before 1-4-32 and not having paid income tax for 1935-36 or any previous year, and businesses which have incurred heavy expenditure as preliminary expenses or expenses in connection with developmental or experimental work in the standard period, are specially mentioned.<sup>4</sup>

The wide discretion granted to these bodies raises one very interesting question. What exact criterion should they follow with regard to raising profits? Should they try

<sup>1</sup> Finance Act (No. 2) 1939 (U. K.), Sec. 18 (7).

<sup>2</sup> It must be remembered that the statutory percentage is much higher than 6 per cent.

<sup>3</sup> Sec. 26 (1).

<sup>4</sup> Sec. 26 (2).

to calculate profits as they would have been but for the war? Or, should they go about with charitable hearts and grant relief in cases even where they find that the miseries of the industry are not due to any special circumstances which would have been removed in course of time, but due to causes which would have continued? This question arises with special force in case of declining industries. Really speaking, in such cases there is no reason to utilize this discretion. Since our aim is to tax all war profits, not only high profits, there is no reason why we should grant the declining industries any allowance. In the last war, the decision of the Board in U.K. was the same.<sup>1</sup>

(c) **Alternative Percentage Standard:** There is still another way in which the hard cases can be minimized, viz., an alternative provision of a percentage standard. The E.P.T. in England during the last war gave the businesses freedom to either compute their standard profits as those made during the standard period, or as a certain percentage on the capital employed. The rate was fixed at first at 6 per cent in case of companies and 7 per cent in case of private firms.<sup>2</sup> For accounting periods ending after 31-12-1916, the percentage was raised to 8 per cent in case of private businesses. Some changes followed later. The broad result of this provision was to provide an automatic exemption in those "hard" cases, where due to some reason or the other the pre-war profits were less than a certain percentage. The statutory percentage provision was resorted to only in some cases, as the pre-war percentage of profits was usually higher. Nonetheless, this choice must have obviated the necessity of a good many appeals to the Board.

To this provision, however, there are many objections. Besides necessitating the almost impossible task of computing capital, such a provision fails to distinguish between cases which deserve relief, and cases which do not. It

<sup>1</sup> Stamp, 'Taxation During the War,' p. 173. The effects of this decision were much mitigated by the alternative percentage standard.

<sup>2</sup> Haig, p. 91. The greater percentage allowed to private businesses in all such cases is because of the fact that whereas the profits of a company exclude wages of management, the private business profits include them.

amounts often to a bounty to existing shareholders. Take, for example, a company making a standard profit of 3 per cent not due to temporary causes, but due to reasons likely to have persisted. If the market rate of interest is 6 per cent, the prices of its Rs. 100 original shares would have declined to Rs. 50. With the optional percentage at 5 per cent, if due to the war the company can make a profit of 5 per cent, and if the excess profits tax is laid down at cent per cent, the market prices of the shares will rise to more than Rs. 83. Many of the shares will, in the meanwhile, have changed hands, so that persons who bought on the basis of 3 per cent interest will be unduly benefited. The process will be reversed, when the excess profits tax will cease, and the new shareholders will, for no fault of theirs, be unduly penalized.<sup>1</sup>

Much more objectionable is an excess profits tax, which provides only a percentage rate for the computation of standard profits, more rightly called a "high profits tax." The American war profits tax during the last war was of this nature.<sup>2</sup> The Indian Excess Profits Tax after the last war was very similar. It was imposed in 1919 at 50 per cent on profits exceeding 10 per cent. Such a tax suffers not only from the defect we have mentioned above, but also from a contrary effect. Firms making peacetime profits higher than the statutory percentages are adversely affected. The shares of such firms will go down in value. When the excess profits duty is repealed, the consequences will be reverse. The harm that a high profits duty of this variety may do depends on the rate of the tax and the time for which it is allowed to last. Where the tax is light, the changes in the capital value of shares both after the imposition and the repeal of the tax will be mild. Where

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1 In so far as such a fall is expected, the argument loses its force.

2 American war profits tax had a chequered history. It was levied in 1917—before the American entry into war—on the high profits principle. In 1918, however, a real excess profits tax was enacted, which, while leaving the former tax intact, reduced it to a nullity, since only the higher tax was to be charged, and E. P. T. was often the higher.

the tax is permanent, the effects after the repeal cannot follow.<sup>1</sup>

While the alternative use of, or the sole resort to, percentage profits to determine standard profits is highly undesirable and administratively very difficult, the method has to be relied upon in certain cases. There are many new industries started just before the war, or during the war, to which the application of the standard period is unfair or impossible. In case of all these to compel a reference to tribunals means an unnecessary increase in the work of these bodies and a great hardship on such businesses. A resort to the percentage standard forms an easier way out. Since the firms did not exist long before the war, no great bounty to shareholders is likely to result. The computation of the capital of firms so recently started is an easy task. Thus, the administrative and economic objections to a statutory percentage standard lose much of their force. Both the British and Indian E.P.T. Acts passed during this war provide for new or very recent firms in this way. The British Act provides that in case of a trade or business commenced after 1-7-1936 the statutory percentage method shall be followed.<sup>2</sup> The Indian Act allows all businesses which were commenced on or after 31-3-1936, to choose, if the owners so want, the statutory percentage standard.<sup>3</sup> The percentage laid down is 8 per cent in case of companies except where the directors have a controlling interest, and 10 per cent in all other cases.<sup>4</sup>

There is also another case, in which a percentage computation is found to be essential. Increases and decreases in the capital of a company of a private business are bound to persist even in war time, and some allowance must be

1 It is, therefore, that in discussing a peacetime excess profits tax, we have not considered these objections. Such a tax is likely to be a permanent feature of the tax system, and the rate will be light.

2 Sec. 18 (8). It must be remembered that the Act does not, in any case, provide the year 1937 to be taken as a standard period. No ease of option, therefore, arises.

3 Sec. 6 (1). The Indian Act does give an option unlike the British Act.

4 Sec. 2 (21). The percentage is increased to 10 and 12 per cent respectively in case of industries starting on or after 1-7-1938. The British statutory percentages are 8 per cent and 10 per cent in all cases.

made for this. For cases of capital increase, a rise in the standard profits calculated on the statutory percentage basis is provided for.<sup>1</sup> For cases of capital decrease, a decrease in standard profits, usually on a lower percentage basis, is laid down.<sup>2</sup>

(d) **Depreciation Allowance:** We have dealt so far with hard cases, where difficulties arise in computation of normal peacetime profits. But there are also cases, where hardships are met with in computation of actual profits during the war. Often it happens that the capital equipment of an industry depreciates unusually during war time. War-time profits calculated in the usual way will mean injustice in such cases. So also in cases, where much of the machinery and buildings taken during war time will be rendered useless after the war. For these, special provisions have to be made. Under the 1915 Act in U.K. a power was given to the Commissioners of Inland Revenue to sanction extra allowances for exceptional depreciation on these grounds among others.<sup>3</sup> A further appeal lay to the Board of Referees. The present act gives such a concession only in case of equipment installed after 1-1-1937, if it proves to be obsolete after the war. The allowance is to be fixed at a sum equal to the selling price of the equipment at the actual time of selling, or at a date determined by parliament minus the written down value. The allowances can finally be settled only after the war but in the meanwhile, the C.I.R. may allow a provisional allowance not exceeding 10 per cent of the net cost.<sup>4</sup> The Indian Excess Profits Tax Act is more liberal in this respect. It empowers the Board of Revenue to grant special relief in cases where they think that computing profits according to usual rules may prove unjust because of (a) any postponement or suspension, as a consequence of the present hosti-

1 Sec. 6 (1).

2 The decrease is, both in case of companies and private firms, provided at 6 per cent; in case of industries starting after 30-6-1938, 8 per cent is provided for. The British Act provides for 6 per cent in all cases.

3 Haig, pp. 50-52.

4 Part I, 7th schedule to U. K. Finance Act (No. 2) 1939. In addition to this, ordinary income tax allowance may be granted, if essential.

lities, or renewals or repairs, or because of (b) the provision of buildings, plant or machinery which will not be required for the purposes of the business after the termination of present hostilities.<sup>1</sup>

### Rate of Excess Profits Tax

While, in theory, there is a case for a cent per cent excess profits tax, the possibilities of evasion that it may give rise to, and the serious encroachment on willingness to work and enterprise it may mean, compel the State to be content with less. Where a cent per cent tax is levied, once the business has reached the standard profits level, the businessman has nothing to lose in risking anything beyond that sum or giving away anything beyond it. In the last war, where at its highest, the British tax was only 80 per cent, many cases of evasion took place. Advertisements on a lavish scale were indulged in; unprecedented developmental and experimental schemes were embarked upon; and all other costs of future investments were liberally multiplied. For the first time, employers became solicitous about their employees and granted liberal allowances. With a 100 per cent profits tax, the efforts at evasion would greatly multiply. United Kingdom started in this war with a cent per cent tax, but in April 1940, they reduced this to 80 per cent.<sup>2</sup> To check evasion, vast powers have been given to C.I.R. to disallow any expenditure they think unreasonable. The fees of the managing agents have been specially controlled. In India the tax is lighter. It was 50 per cent upto 1941-42, and was increased to 66-2/3 per cent in April 1942. Since April 1944, the whole of the excess profits which remains with the companies after the payment of the excess profits tax and the corporation tax has to be deposited with the Government, and will be returned by it at the end of the war. In addition, the Government will contribute itself 6-2/3 per cent of the excess profits which will be given to the tax-

<sup>1</sup> Sec. 26 (8).

<sup>2</sup> The whole of the excess profits is taken away by the State, but 20 per cent of this is treated as "compulsory savings" to be paid back after the war.

payers not later than two years after the war on such conditions as might be decided by the Government in consultation with the Post-War Reconstruction Committee.

While, on theoretical grounds, there is no reason to exempt small firms, because of the great difficulties involved in the administration of the excess profits tax, it is held advisable to reduce the number of firms liable to pay the tax. The Indian Excess Profits Act follows this salutary rule and fixes the minimum standard profits at Rs. 36,000.<sup>1</sup>

### Scope of the Excess Profits Act

On practical grounds the scope of the E.P.T. has to be restricted. While in businesses and trades the supposition that all excess profits during the war are war profits is broadly true, we cannot say the same of professions, where individual skill and seniority count for more. Even during the war, the normal upheavals in profession—new individuals rapidly climbing up the ladder and old ones especially their successors falling out—continue. To bring them within the scope of the Act will mean either a great addition to the work of the Board of Referees, or unnecessary hardship and injustice to rising stars among the profession. Both the British and the Indian Acts<sup>2</sup> rule out of their scope “a profession carried on by an individual or by individuals in partnership if the profits of the profession depend wholly or mainly on his or their personal qualifications.” However, professions consisting in making contracts on behalf of other persons or giving to other persons commercial advice in connection therewith are liable to excess profits tax. Thus, stockbrokers and other brokers will not be exempt.

Sometimes, the exemption has been extended unjustifiably to agriculture. The profits of husbandry were, under

<sup>1</sup> Sec. 6 (4). In case of coal mines, however, the minimum has recently been raised to Rs. 72,000. The English counterpart provides for a minimum of £1,000, or £150 per working proprietor upto a limit of £3,000.

<sup>2</sup> The wordings are of the Indian Act, but the British provision is the same.

the E.P.T. in U.K., not liable to excess profits tax;<sup>1</sup> under the new duty, however, they are included. In India, following the U.K., agriculture is included, though with our scale of agriculture, very few persons will be liable to it. Sometimes, the scope of exemption is still further widened. The 1918 U.S.A. law applied to corporations only, and exempted even personal service corporations.<sup>2</sup> Such a provision is absolutely unjustifiable, more so in the case of U.S.A., where the earlier similar acts were all-embracing, even professions being included.

### Provision for Losses

We have seen in Chapter III the urgent necessity of making some provision in the levying of income tax for business losses. We saw there the inadequacy of such a provision as a substitute for the average method, when the rates were progressive. In case of E.P.T. the provision for losses is more adequate, as the rates are flat. Since the aim of E.P.T. is to tax excess profits during the war as a whole, there must be no time limit for the carrying forward or backward of losses except the duration of the Excess Profits Tax. The present Indian Act is satisfactory in this respect. There is a provision<sup>3</sup> whereby if the actual profits in any chargeable accounting period are less than the standard profits, the amount of excess profits earned during the past accounting periods is reduced by that difference. Where the profits of the past years are inadequate, the balance of the deficiency is to be carried on to future. In England, also, there is a similar provision.<sup>4</sup>

### (iii) Excess Profits Tax in Particular Industries

Certain industries, especially the armament industry, are likely to be enjoying excess profits long before the war. The preparations for war have their effects first in this field. Before the war preparations make an impact on the

<sup>1</sup> Haig, p. 10.

<sup>2</sup> *Ibid.*, p. 10.

<sup>3</sup> Sec. 7.

<sup>4</sup> Sec. 15.

whole industrial and economic life of the nation, some time elapses. During this time, a partial Excess Profits Tax on the armament and other war industries is often levied. In England in the spring of 1939, for example, an Armament Profits Duty Act taxing the excess profits of munition firms was passed. It was merged in E.P.T. afterwards. The Munitions Levy of the last war was slightly different. It was passed after the war (July 1915), because the E.P.T. came much later, and continued to be separately administered until 1-1-1917.<sup>1</sup> In India, no question of a separate levy could arise, as it had no pre-war preparations, and no big armament industries. The principles, on which such a tax ought to be levied are the same as those of E.P.T., so that we need not go over them again.

### Conclusion

The Indian Excess Profits Tax Act, 1940, thus, proceeds on well-recognized economic principles, and compares favourably with similar statutes in other countries. The only broad defect of it, that can be pointed out, is its choice of standard period. But this choice is always a difficult and controversial problem. The choice in United Kingdom has also been criticised severely. Regarding other business taxes, however, the position is unsatisfactory. Of the three countries, England, U.S.A. and India whose tax systems we have examined, England has only the undistributed profits tax, and U.S.A. the corporation tax. It is only India that has both these. The super tax on companies is based on the principle of measuring the additional ability that the privilege of incorporation provides by the net income of corporation, is levied at a light rate and may well be retained. But the undistributed profits tax that India levies is, to our mind, hardly justifiable, and must be done away with.

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<sup>1</sup> Haig, pp. 6-7.

## CHAPTER VI

### TAXATION OF LAND

#### I. Incidence and Justice of Various Land Taxes

From time immemorial, land has been regarded as a particularly fit object for taxation. This, combined with a belief in the special character of income from land, has led to the prevalence of a vexatious multiplicity in the methods of land taxation. Since the incidence of a tax on land varies with the way in which it is imposed, a complete study of the incidence of land taxation will necessitate an examination of all these multiple methods. We shall confine ourselves, however, only to modern methods of land taxation<sup>1</sup> so as to make the task handy and of practical use.

(a) **Tax on Income from Land as on other Species of Income:** The most usual land tax in all civilized countries is the taxation of income from agriculture in the same way as that from any other source like trade or industry. Such a tax, since it is a part of the general income tax, can neither be shifted nor capitalized, as there is no other tax-less or less taxed field to which capital or labour occupied in agriculture can repair. The tax will, thus, rest only where it is imposed. Against the justice and equity of such a tax there is little to be said. Like all other varieties of income tax, it is best suited to observe those fundamental requirements of justice which we saw in Chapter I.

(b) **Death Duties on Land as on other Species of Property:** In almost all countries, where death duties are levied, they are levied on agricultural land also. Such a tax has the same incidence, the same justification, the same

<sup>1</sup> For a short account of these, see Appendix III to the Report of the Indian Taxation Enquiry Committee, Vol. II, pp. 22-26; also Note G to the 'Report of the Punjab Land Revenue Committee,' pp. 228-232.

defaults and defects,<sup>1</sup> and the same advantages as a death duty on other forms of property. These have been already discussed at length in Chapter IV.

**(c) Tax on Land Value as a part of Property Tax  
Its Advantages**

A property tax on land, like the general property tax, has much to commend itself. In case of land, there is a special reason making a property tax welcome. There is a growing complaint at present that a substantial part of land is not put to proper use, thus injuriously affecting national welfare. Since the selling price of land is not determined by the actual income realized by the present owner, but by the income that will accrue if land is put to the best possible use, a property tax based on selling price of land is likely to prove a valuable incentive to the land-owner to put forth all his effort to utilize his land best.

**Its Defects**

**(i) Taxation of Psychic Elements:** In spite of these advantages, modern economists do not enthuse much over a property tax. The selling price of any property is not determined only by its net money income; in it also are reflected the non-monetary psychic advantages derived from possession of property. In general, it is not considered unjust to tax these benefits. But in case of land, the psychic advantages are so great, that a property tax on land acts as a great hardship to the landowners. It is especially, so in backward areas, where land ownership carries an unduly high social prestige.

**(ii) Taxation of Future Incomes:** The prospects of a future income count as much as the present income in determining the selling value of property. A tax on property is, therefore, a tax not only on the present, but also on the future, incomes. Ability and sacrifice, however, depend not so much on future proceeds as on current in-

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<sup>1</sup> As we have seen in Chapter IV, a duty on land is more likely to have been provided for by the deceased by extra work and/or by less consumption. Its effects on production may, therefore, be less adverse than in case of other properties.

come, and a tax taking into account future incomes may cause serious inconvenience. E.g. a property that yields nothing to-day may in three years' time bring in an annual income of Rs. 550. If the market rate of interest is 5 per cent and the future income is certain, the property will sell for about Rs. 11,000. Even if the tax on property is moderate, say 0.5 per cent, this property which is yielding no income to day will cost its owner Rs. 55 a year. While this defect is inherent in all forms of property tax, in case of a land tax the injustice is greater, because in its case the future prospects are likely to differ widely from the current yield. In extreme instances, relief can be provided for by special rules. When any area is first brought into cultivation, for some years the charge may be kept specially low, or the whole tax may be remitted. But in individual cases, and where the results are not so absurd but still inequitable, no such provision is likely or even possible. The fact of such a tax taking future falls in income also into account does not detract from this inequity.

(iii) **Administrative Defects:** The facilities for evasion of a property tax vary widely with different forms of property. Intangible property, which forms a large portion of urban wealth, can be very easily concealed. The tax on personal tangibles, though less easily evaded, can be escaped from in a larger number of cases than that on real estate. Rural property consists mostly of land; the few tangibles that the farmer has for purposes of cultivation are easily noted and valued. Land and the rural population are, thus, at a great disadvantage and are greatly discriminated against by the general property tax.<sup>1</sup>

#### Incidence of the Tax

The incidence of a tax on land values as a part of the general tax on property is uncertain. Since the money incomes from different sorts of property are at widely different rates, there is a possibility of capitalization of the

<sup>1</sup> Cf. "What is practically a real property tax in the remainder of the State becomes a general property tax in the rural regions"—Seligman, 'Essays on Taxation,' p. 28.

tax, and also of partial shifting. A general property tax in practice falls with special severity on the landowners, and may therefore be thought to give rise to both these contingencies. But this possibility is not great. As we shall soon see, the mobility of capital employed in land is little; some flow of new capital to land is almost inevitable under any circumstances. The practical differentiation that a general property tax makes between land and other forms of property shall have to be great, and subsist for a long time before it can make its effects felt. This can happen rarely as the discrimination is usually much mitigated by the fact that a great part or the whole of the property tax is a local source of revenue.<sup>1</sup> Since the benefits of local expenditure mainly go to real estate situated in the area, no shifting is likely to take place, until the differentiation greatly exceeds the benefits.

#### (d) Taxation of Unearned Increments

So far we have seen only those instances where land is treated on par, at least in theory, with other forms of property. But there are, also, many cases where land is taxed in special ways. The most logical of these is an attempt to tax unearned increment in land values. The growth of population, the increase in national prosperity, the development of the means of communication, and the betterment of the transport system, combined with the limited supply of land, increase the value of land by leaps and bounds. The rise is general in new countries and local in old ones, but in neither case, it is due to the foresight or the intelligence of the owners. The landholders, thus, reap where they have never sown. It is only proper that the community should take back a great part of this unmerited increment by way of taxation. Great difficulties, however, arise in determining what portion of land value is unearned. The fact, that the selling price of land is determined on the same considerations as that of other forms of

<sup>1</sup> E. g. in U. S. A., while the States obtained 0.2 billion dollars from this source in 1937, local bodies got 4.3 billions—'Facing The Tax Problem,' p. 11

capital and that in our society land is easily transferable, adds greatly to this difficulty. Various ways of taxing have been devised to get over these:<sup>1</sup> (i) The crudest way is to select some date in the past and tax all unearned increments that have occurred since then. Such a method is greatly objectionable. To determine the present value of land is, in itself, a difficult task; to determine land value at some date past with any accuracy is well nigh impossible. Even if due to elaborate land records or some other way, this difficulty can be got over, another fatal objection to such a scheme remains. Land may have changed hands, after the unearned income has accrued. The present owner has, in that case, already paid for the unearned increment and has earned it. In his case, therefore, the increment is no longer unearned. To tax him on this is obviously inequitable. (ii) To remove this objection, attempts have been made to tax only future unearned increments in some countries. It is announced in advance that all unearned increments accruing after a certain date shall be taxed. The new buyer in making his offer will discount this tax, and therefore the incidence of the tax will be only on the present owner, who has himself derived the benefit. It will be noted that in order that such a tax may not prove unjust, not only the fact of the tax, but also its rate should be announced beforehand. Even then, the difficulty will not be completely removed. A person, who has bought the land after there have been reasonable prospects of realizing an unearned increment, has, in his purchase price taken account of this. The proposed tax, while it exempts all past unearned increment, can certainly make no provision for past prospects.<sup>1</sup> Administrative difficulties in land valuation add to the troubles, and make the tax not worthwhile in old countries. The 1910 law in England, providing for a 20 per cent duty on all increments in land value exceeding 10 per cent after 30-4-1909, had to be abandoned in 1920 due to this reason. The tax proceeds

<sup>1</sup> See Bickerdike's article "The Principle of Land Value Taxation" in 'The Economic Journal,' March, 1912 and Stamp's reply to it in the same Journal, June, 1913.

were found to be low and the cost of tax valuation high. In new countries, however, where due to rapid all round development unearned increment is very high, this tax has been found to be a success. In New Zealand, this is the only special land tax. Both there and in Australia, careful provisions are inserted to see that all increments due to personal improvements are left untaxed.<sup>1</sup> (iii) In old countries, where the prospects of a considerable all round increment are little, it is better to confine the tax only to those regions, which are undergoing a great change, and whose land values are likely to rise rapidly because of the change. When the conditions settle down, the tax should be repealed. In India, acts have been passed providing for levy of such betterment taxes by local bodies.<sup>2</sup>

### (e) Special Tax on Income from Land

#### Its Incidence

**Classical Theory:** Besides the tax on increments in capital value, land has often been taxed in various other exclusive ways. The logic for such taxes has been simple. Nature being niggardly in providing the best land, plots vastly differing in quality and fertility have to be utilised. The costs of production on these different lands vary greatly. The market price, that their products command, is the same. It will be under competitive conditions equal to the cost of production on the marginal land, i.e., that piece of land, which will yield the same reward to the application of labour and capital as other fields of production. If the market price goes above this cost, inferior i.e. sub-marginal lands will be brought into cultivation; the supply of agricultural produce will increase, and prices will be brought down. If the price goes below this, labour and capital employed on the marginal lands will not get the reward they can obtain elsewhere, and will therefore shift to other spheres. The result of this phenomenon is that labour and capital employed on intra-marginal land yield greater re-

<sup>1</sup> Shirras—'Science of Public Finance,' pp. 401 and 402.

<sup>2</sup> 'Report of the Indian Taxation Enquiry Committee,' para 117.

wards than elsewhere. This surplus is called rent, and under conditions of perfect competition goes to the landlord. Any tax on land upto the amount of this rent will rest on the landlord who cannot decrease the supply of land. A tax greater than rent will be a tax on the reward to labour and capital, which will move elsewhere, causing the excess to be shifted to the consumers of agricultural products. A tax on land income exceeding the rent will, thus, partake of the character of a consumption tax, regressive and unequal in its incidence.

This classical theory of the incidence of a tax on land, while fundamentally true, requires to be greatly modified in light of real conditions. The economic rent as being the reward of "original and indestructible properties of the soil" is no longer found in its pristine purity anywhere. The soil of today owes as much to nurture as to nature. The "rent" that the landlord gets for it is, frequently enough, only the interest on the capital that he or his ancestor has spent in permanent soil improvements. In any case, the economic rent is inextricably mixed up with the interest on the capital spent on land improvements. Even if the two elements could be separated, we would not get any valuable results, because a return to much of the capital itself can be taxed without any likelihood of its being passed on. In a landlord-tenant system, for the time being, the capital that the tenant is spending must get its due reward, so that a tax that goes beyond the landlord's share will be shifted temporarily to the consumer, but soon this capital also will become an ingrained part of the soil.<sup>1</sup> Any tax, therefore, which absorbs only rent and profit on capital spent in permanent improvements, cannot be shifted. There is, in most cases, still one more element which a tax on land may eat into without being shifted to the consumers. Agriculture, all over the world, is a very small-scale industry, and it is well known that owners of small establishments are oft content with much smaller rewards to their labour and management than they would get elsewhere. They set

<sup>1</sup> Silverman—"Taxation, Its Incidence and Effects," p. 266.

more value by their independence than by monetary rewards. This is specially so in case of agriculture. An owner of land, however poor, is considered more respectable than a prosperous landless labourer or tenant, and a farmer will try to put off the day of his relegation to this rank as much as possible. The only alternative usually open to a farmer of earning his living without losing his face, viz., turning into a mill-hand, necessitates a great psychological adjustment. From the field to the factory, from working in the sunshine at one's sweet will and under nobody's command to working at the bidding of the whistles under a rigid discipline is a far-off cry. Moreover, the income from agriculture is very uncertain and fluctuating. A moderate decrease in it can only be known, if accounts are kept for a number of years and this is too much to expect of even an intelligent farmer. The result is that only a widespread ruin and devastation can bring home to the farmer the fact of the diminution in his income. A modern tax is seldom likely to err so much. In India, these general considerations are further reinforced. The farmer here does not know even how to read and to write. His dependence on nature is greater than in other countries. Agriculture and allied industries occupy so much population that there are very few other fields to move to. Under these conditions, even an exorbitant tax on land is likely to rest only on the farmer.

The question naturally arises: "Is it possible for the landlord to shift the tax on to the tenant?" The reply of the classical theory is a prompt "No". But this "no" has to be greatly modified by a consideration of the above arguments, which apply *mutatis mutandis* to the tenant also.<sup>1</sup> Moreover, in many cases, our rents are customary, and the tenant has to pay at times a fixed portion of the land revenue. Under such conditions, a part of the tax is shifted to the tenants automatically and there is little likelihood

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<sup>1</sup> For a further development of this argument see Seligman—"Shifting and Incidence of Taxation," pp. 271-275.

of a change in other tenancy terms even at the end of the lease to compensate the tenant for his increased tax.<sup>1</sup>

### Capitalization of the Tax

The tax on land, though likely to rest on landowners, is not like other such taxes usually capitalized even when it exceeds rent. The process of capitalization, as we have seen, depends on the frequency of transfer. Land is, comparatively, an immobile form of property. Its annual produce and value are widely fluctuating, so that it is very hard to discount adequately the existence of a tax on it. Besides, as we have already seen, the psychic elements in fixation of land value are great. All these limit greatly the possibilities of capitalization.<sup>2</sup>

### Difficulties in Taxing Rent

The special tax on land, thus, usually falls on the landowners and/or on the tenants. It is unfair to ask them to pay higher rates of tax than the general taxpayers except in so far as they are earning economic rent. To tax this rent is perfectly just, but the great difficulty has been how to separate this from the various other elements of agricultural profits. No satisfactory way has yet been devised to solve this problem, but various compromises have been arrived at. The most usually adopted way has been to impose a tax at a small flat rate on all agricultural incomes. In Hungary, for instance, a tax of 8 to 12 per cent of net agricultural yield is levied; in Italy the land tax is levied only on rental values at 7½ per cent.<sup>3</sup>

## II. Correct Method of Land Taxation

### Income Tax on Agricultural Income

The modern tendency in central and provincial land taxation has been to tax income from land in the same

<sup>1</sup> In some of the Provinces, where tenants of certain defined categories have been protected against eviction by law, and where changes in rent are allowed only under certain circumstances, the specific provisions of law will decide who is to bear further land taxation.

<sup>2</sup> Even in case of such an old tax as the English Land Tax with the alternative of redemption and the freedom of buying out, the English authorities were not sure that the tax was capitalized. Hence, the recent exemptions and reductions in the tax—Shirras, p. 399.

<sup>3</sup> The taxes are nominally much higher, since the tax is based on old registers. *I*ide 'Indian Taxation Enquiry Committee,' Vol. II, Appendix III.

ways and at the same rates as the income from other sources.<sup>1</sup> The only special method of land taxation has been a low flat-rate taxation resorted to in order to tax the rent part of agricultural income. And this—except in so far as the flat rate is a crude and inefficient device to tax the "rent" part of agricultural income—is as it should be. The income tax principles are the best fitted to achieve justice in taxation; and there is no reason why they should be departed from lightly and without very strong grounds in case of a tax on land. Such grounds exist only in cases of the tax on rent and that on unearned increments in land value. The rules of exemption and progression, that are the marks of the modern income tax systems, must also be observed in a tax on land incomes. To say that "land revenue is essentially a tax on things and not on persons,"<sup>2</sup> or that "it is a 'real' tax on the produce of the land, independently of the amount of income accruing from it to individuals,"<sup>3</sup> is to ignore entirely modern developments in theory of taxation. All taxes are paid by persons, whether they be levied with regard to personal circumstances or not. The only case in which personal factors may be justly neglected is when an undeserved gain has accrued, and where the tax proposed to be imposed does not exceed this benefit.<sup>4</sup> To go further, and say that the exemption of small incomes from the income tax has not been introduced to satisfy the test of ability but only to suit administrative convenience and therefore need have no application in case of land where elaborate records of all holdings are even otherwise essential,<sup>5</sup> shows an appalling ignorance of the first principles

1 In France, however, the agricultural profits tax schedule is lower than other income tax schedules.

2 'Report of the Indian Taxation Enquiry Committee,' para 89.

3 'Report of the Punjab Land Revenue Committee,' Note C, p. 173.

4 We have noted this in discussing business taxes.

5 "The chief reason moreover for exemption of small incomes from income tax does not apply in the case of small holdings paying land revenue. Certain exemptions given to small incomes from income tax are in many countries given with a view to producing certain economic results, but exemptions from income tax, specially adopted less as a matter of principle than in order to avoid the assessment and expense which the necessary enquiries into entail. In the case of land revenue, on the other hand, the small holdings are dealt along with the rest;

of taxation. It is true that the level of income, below which no income tax should be levied, is determined on administrative grounds, and a lowering of it would be desirable from the viewpoint of justice. But when this is not possible with regard to non-agricultural incomes, to select out for differential treatment income from agriculture, which pays the same commodity taxation otherwise, will be gravely unjust. Moreover, income tax as imposed at present has many other characteristics, which cannot claim their origin in administrative convenience. The personal allowances, the progressive rates, and the differentiation between earned and unearned incomes, would never have been introduced, if administrative considerations ruled paramount. The fact that these are adopted testifies to the awakening of the sense of justice in the community, and there is no reason why the benefit of this should be denied to agricultural incomes. It is, therefore, imperative on us to apply the income tax principles and also rates, except in so far as modifications are needed by the very nature of the case, to incomes from agriculture.

### Difficulties in Determining Agricultural Incomes

Income from agriculture is, however, hard to calculate, and the farmers seldom keep accounts. A similar difficulty is met with at times in cases of small retail merchants. But in the case of farmers, the difficulty is greater. To get over this, a presumptive rule of ascertaining agricultural income is adopted. In U.K. the occupier of the land, whether he be the owner or the tenant, is presumed to earn from occupation an income equal to its gross annual value.<sup>1</sup> This

(Contd. from p. 130)

the necessary data have in any case to be provided and the assessment of small holdings entails no extra harassment or expense". 'Report of the Punjab Land Revenue Committee,' p. 173.

<sup>1</sup> *Ibid.*, para 54. The gross annual value is reviewed usually every five years. The greater agricultural profits due to the war have compelled the British Government to lower the scope of this presumption, and to increase the ratio of profits to gross annual value in the presumptive rule. By the Finance Act, 1941, this presumption could only be availed of by farmers occupying land with a gross annual value of not more than £300. By the 1942 Finance Act the limit has further been lowered to £100; in cases, where the annual value does not exceed £100, the income is presumed to be thrice the annual value.—Taylor and Bayley, "Income Tax, Sur Tax and National Defence Contributions", pp. 456, 457 and 473.

is obviously based on the assumption that "there is some correlation between the rental value of the land and the farmer's profits."<sup>1</sup> This is not a very satisfactory assumption. The return, which a cultivator obtains from a farm, depends much on his skill, intelligence and the amount of working capital he applies—factors which have nothing to do with the rent. The Government in U.K. seems to have been keenly conscious of this defect for it has varied this presumption quite often.<sup>2</sup> Nonetheless much hardship does not result from this, as the presumption is rebuttable. It is open to the cultivator to show that his actual income is less.<sup>3</sup> Since the exemption level is quite high, the cultivator affected is in a position to keep correct accounts. In many other countries,<sup>4</sup> it seems, no such presumption is adopted. While the lack of this may not cause much hardship in case of a general income tax, it works very hard with respect to a flat-rate tax, which is levied on the smallest incomes. To get over this trouble most countries rely on out of date records which have only a remote connection with existing realities. A frequent revision of these alleviates the difficulties, but it is hard even in that case to take account of that supreme principle of income tax, viz., adjusting current tax to current income and ability.

### III. Land Taxation in British India

Having examined the ways of land taxation in other countries, the way in which such taxation ought to be levied, the difficulties in the task, and the methods adopted to overcome them, we shall now pass on to consider the system of land taxation in British India and the change that should be made in it to make the system more in keeping with the dictates of justice.

<sup>1</sup> Report of the Royal Commission on Income Tax, para 445.

<sup>2</sup> Stamp—The Fundamental Principles of Taxation, p. 253.

<sup>3</sup> In addition to this, the agriculturist has the option of being assessed on the current year's profits. This has given rise to much criticism.—See the Article "Farmers and the Income Tax" by R. S. Edwards in *Economica*, 1937, pp. 208-15.

<sup>4</sup> In France, however, a complicated assumption is utilized. The ratio of income to rent is presumed to vary with different types of land.—Green, p. 275.

### A. Permanently-Settled Areas

The most fundamental feature of present land taxation is its surprising lack of uniformity, and its most notable defect has lain in the differentiation between temporarily-settled and permanently-settled areas. The latter constitute about 18 per cent of the total assessed area. The ruling ideas of the time,<sup>1</sup> the need for a stable revenue, lack of sufficient knowledge of the indigenous land revenue system and the necessity to have a class on whose support they could rely in times of stress led the East India Company to the adoption of permanent settlement in great parts of Bengal, Bihar and Orissa, and some parts of U.P. and Madras. Since all the areas were not simultaneously settled, and the ideas fluctuated with times and personages both here and in England, and since the experience of the permanent settlement was not happy, the system was not extended to all the areas. In these permanently-settled areas, land revenue demand is fixed once and for all; the advantages of an increase in the area of cultivation, or of improvement in land go entirely to the land-owners.<sup>2</sup> The demand being fixed in money, the benefits of rising prices also accrue to them. Originally, the demands for these areas were fixed very high, the exact rates differing with places. In Bengal, ten-elevenths of the net rentals of the landlords were taken away by way of taxation; in the latter-settled Madras, the demand was comparatively light, two-thirds. The result of such a heavy tax in Bengal was a large number of failures to pay land revenue, and an appalling number of evictions. But as time went on, both the extent of the area under cultivation and the price of the produce increased. The revenue demand as a result became lighter and lighter, till to-day the light way in which these areas are being let off has become a matter of serious complaint. It is calculated that due to

<sup>1</sup> It must be remembered that in Great Britain also in the same decade the land tax was permanently fixed. This idea greatly appealed even to the Indians throughout the nineteenth century. The Indian National Congress went so far as to recommend it in one of its sessions. See the famous controversy between Lord Curzon and Romeshchandra Dutt.

<sup>2</sup> Report of the Bengal Land Revenue Commission, para 44.

this system the Bengal treasury is annually incurring a loss of two to eight crores of rupees.<sup>1</sup> In Madras, the permanently-settled tracts are paying less than 20 per cent of the rentals as land revenue.<sup>2</sup> Constituting about 1/4th of the total area, they contribute only 6 per cent of land revenue.<sup>3</sup> This means an undeserved gift to the landholders, and an unnecessary burden on others.

The permanent settlement is, to-day unanimously looked down upon. A permanent promise binding down the hands of the State is always to be condemned, regardless of its financial implications. Even when it leads to a gain, the gain is ill-got and justice is sacrificed. This is generally acknowledged. But the question is, the promise having been once given, does it behove us now to break it?

An attempt may be made to bypass this promise by taxing income from agriculture in permanently-settled areas at a higher rate, the difference in rate being such as to exactly undo the inequity otherwise done to temporarily-settled areas.<sup>4</sup> This, however, will not be possible. In no province, all land is permanently settled,<sup>5</sup> and it is highly doubtful whether an agricultural income tax can be confined only to particular areas within a Province. In any case, the growing inequality among the zamindars will continue. Is it not much better, and more honest, to lead a frontal attack on the system? The legislatures, representing the will of the people, have certainly the right to change any systems or laws, whatever the promises of the past Governments. It is especially so, when the promise

1 Report of the Bengal Land Revenue Commission, para 73.

2 Dr. Thomas—The Zamindari Problem in Madras—Indian Economic Journal, July 1940, p. 1. Needless to say, this only holds true of the landlords in the permanently-settled areas as a whole. No rule can be laid down as to the ratio that land revenue payments bear to the net rentals in case of individual zamindars, for the advantages of extension in cultivation, of land improvements, and of price rises do not go uniformly to all. The permanent system, thus, also creates a great inequity among the members of the Zamindari class.

3 Thomas—Federal Finance in India, p. 445.

4 When a general income tax on all incomes including agriculture is imposed, this would not be possible. For a slightly different proposal, though on different grounds, see Dr. Rao—Taxation of Income in India, pp. 95-99.

5 Even in Bengal, Bihar and Orissa, a part of the land is settled only temporarily.

has been made by a foreign Government, which in no sense represented the people's opinion, and may be suspected even of not having consulted their interests at all.. Far from its being a question of right it is the duty of the provincial legislatures to change this system, and place land taxation on the same basis as in temporarily-settled areas.<sup>1</sup>

## B. Temporarily-Settled Areas

With regard to these areas, since no past undertaking can be made out to stand in the way of progress, we have a great duty to examine the present conditions and make the necessary changes.

### (a) Basis of Assessment

The first important question that arises is with regard to the bases of assessment. The bases followed are different in various provinces, and are seldom clearly defined. In the Punjab the basis of land revenue fixation is the "net assets", which are so defined as to mean the net rentals which land may fetch in the market.<sup>2</sup> In U.P., the recorded cash rentals of lands under ordinary crops and held by permanent and responsible tenants solely dependent on the land produce furnish the basis.<sup>3</sup> In C.P., the demand is based on the rentals of the landlords; but the rentals themselves are fixed by settlement officers.<sup>4</sup> In Bombay the process by which land revenue was fixed was mainly empirical upto 1939. But the Land Revenue Code of 1879 laid down that in revising assessments of land revenue, due regard should be paid to "the profits of agriculture." The Act of 1939 lays down a number of factors which should be taken into account in fixing land revenue,

<sup>1</sup> Following the recommendations of the Floud Commission, the Bengal Government has declared its policy of buying out the interests of all classes of rent receivers above the lower grade of cash-paying under-ryots. This would mean the abolition of the Permanent Settlement. For the present, however, in view of the financial and other risks involved, the Government has decided to embark on State acquisition on an experimental basis in one district.

<sup>2</sup> Report of the Punjab Land Revenue Committee, paras 68-69.

<sup>3</sup> Report of the Indian Taxation Enquiry Committee, para 67.

<sup>4</sup> *Ibid.*, para 69.

rental value being only one of these factors. The maximum revenue to be levied is fixed in terms of rental value. In Madras, the determinant is the "net produce", i.e., the gross produce minus the cultivation expenses including the reward for the labour of the cultivator-owner.<sup>1</sup> Thus, we have a medley of bases.<sup>2</sup> The need of bringing about some order out of this chaos by selecting one uniform basis is imperative.

(i) **Income as computed for Income Tax Purposes:** Theoretically, our choice is obvious. We would fain have, if only we could have it, income computed on the same basis as for income tax purposes. But, as we have seen, this is difficult everywhere. In our country with its appalling illiteracy, its small-scale farming, and large production for use, these difficulties will prove insurmountable in case of lower incomes. In most of the countries a low flat rate on agricultural incomes is common, and looking to our urgent need for an increase in our revenues, we shall have to keep some such system. For this purpose some procedure other than that adopted for income tax purposes will have to be devised.

(ii) **Net Income:** It may be thought that while agricultural income cannot be determined from year to year and for every individual, something on the Madras lines, where the net produce of a field under average farming conditions forms the basis, is possible. Such a tax would obviously be very different from our present income tax, in that we will be taxing what we think a man ought to earn rather than what he actually earns, and an annual adaptation of the tax to income would not be possible; but it would be a definite improvement on the present. The calculation of the net produce, however, bristles with difficulties. In three of the provinces, C.P., U.P., and the Punjab, where rentals in one form or another are the basis of the

1 Report of the Bombay Land Revenue Assessment Committee, para 21.

2 "In India, the basis may be rentals or net assets. The rentals may be customary, controlled or assumed. The net assets may include or exclude the subsistence of the cultivator."—Report of the Indian Taxation Enquiry Committee, para 95.

modern land revenue systems, the "net produce" criterion will mean an entire overhauling.<sup>1</sup> Even in Bombay Province, the task would be greatly difficult.<sup>2</sup> Our means of estimating gross produce are fairly reliable on the whole, though even here the estimate of the average produce per acre is often erroneous. But we have no accurate knowledge of the costs of even the main crops, so that we have little data for estimating the profits of cultivation. It is better therefore to abandon this test.

(iii) **Rental Value:** The only basis left is that of rental value or annual value. This will suit us fairly well. In all provinces in settlement revisions, increasing attention has been paid to annual values.<sup>3</sup> In three provinces, as we have seen, rent has already been laid down as the determinant of revenue demand. In Bombay, after 1939, annual value is given a very important place, and from much earlier times a good record of leases has been kept.

In the determination of these rentals, however, serious obstacles have to be confronted. We have not, as in England, the separation of the functions of the landlord and the capitalist, so that we cannot have equally great wealth of data to help us in determining annual value. The rent is, often, not paid in cash. Great caution, has, therefore, to be exercised in deciding annual value.<sup>4</sup> An accurate record of leases is the first essential preparation. A weeding out of all the leases, that look suspicious, or where the present tenant was the old owner, is equally necessary.<sup>5</sup> Controlled or customary rents are as good a basis of taxation, and no vain strivings to find out rent that would have prevailed under conditions of perfect competition<sup>6</sup> are needed. Precaution must be taken in cases where the pressure on land is so great, that tenants offer to hire them at rates, which

1 Report of the Punjab Land Revenue Committee, paras 85 and 91.

2 Report of the Bombay Land Revenue Assessment Committee, para 32. It must, however, be remembered that it was only the casting vote of the Chairman that decided this matter.

3 Report of the Indian Taxation Enquiry Committee, para 103.

4 For inadequacy of the present material, see *Ibid.*, Vol. II, Appendix V.

5 *Ibid.*, Vol. II, p. 78.

6 *Ibid.*, Vol. I, para 104.

would leave them less than the wages of permanent agricultural labourers. Some discount ought to be made in this case in deducing "annual value" from market value. While this discretion will have to be left to settlement officers, it should be made clear to them that the only purpose of this freedom is to obtain correctly the real annual value, and not to enable them, as at present, to impose their concept of equity and justice on land revenue demand.

#### (b) Rate of Assessment

(i) **Past History:** Having determined the basis, the next question that arises is as to the rate at which the tax ought to be levied. So far, this question has been dealt with in an absolutely unsatisfactory way. The original rates of taxation were determined by the conditions of the tracts and the ideas current at the time. As we have already noted, in Bengal the demands were fixed as high as ninety per cent. Soon, however, the harshness of such a heavy demand was realized, and in the second part of the nineteenth century the Government demand was fixed usually at two-thirds. Even this was felt to be too heavy, and in the middle of the nineteenth century, the "Saharanpur rules" reduced the demand to 50 per cent. But exceptions were sometimes made, and the interpretations put upon the word "net assets" often meant an absorption of a considerably higher proportion of rentals. At resettlements, however, the discretionary powers of the officials were less, and the rates of land revenue fairly approximated to 50 per cent.<sup>1</sup> Towards the end of the last century, due to severe famines and public agitation, an exhaustive inquiry into the system of land revenue assessment was made by the Government of Lord Curzon. As a result the Government laid down a policy of progressive moderation. At the following resettlements, no attempt was made to fully absorb the greater net assets due to rise in prices, thus reducing further the revenue demands.<sup>2</sup>

<sup>1</sup> Land Revenue Policy of the Indian Government, paras 10-13. See also replies of various Provincial Governments.

<sup>2</sup> Report of the Indian Taxation Enquiry Committee, paras 75 and 92.

All the rules regarding the basis of assessment, the standard rate, the methods of valuation, the period of revision, and enhancements had been so far mainly laid down by the executive. The Joint Parliamentary Committee on the Government of India Bill, 1919, recommended that these should be regulated by statute.<sup>1</sup> The provincial legislatures elected under the Montford reforms were not slow to take the hint. The first to take advantage was the Punjab Government, where in 1928 a Land Revenue Act was passed limiting the tax rate to "one-fourth of the estimated money value of net assets of the circle."<sup>2</sup> U.P. and C.P. soon followed. In the former, by the Land Revenue Amendment Act of 1929, the usual rate was laid down at 40 per cent, and was not to go below 30 per cent except in rare cases. In the C.P. 50 per cent was laid down as the rate. In Bombay, the recent Amendment Act of 1939 fixes the maximum assessment of a group at 35 per cent of the rentals.

Thus, in recent provincial legislation, there is an increasing tendency to prescribe the rates. No longer the legislatures are satisfied with laying down general rules, which leave considerable discretion to the settlement officers. They insist on laying down the maximum which can in no case be departed from, and in the case of U.P. even the lower limit is fairly clearly defined. This is a tendency in the right direction. In the past, there has been such a chaos that various provincial governments, when asked as to what portion of annual value they usually took by taxation, expressed their inability to give any estimate in the matter.<sup>3</sup> Moreover, it was found that in the same province in different tracts, even when rules as to the pitch of assessment were the same at settlement times, and sometime even in the same tract, the rates widely differed. While it is true that the economic rent in different tracts was different, and that, therefore, ideally speaking the incomes from them ought be taxed at different rates accord-

<sup>1</sup> Report of the Indian Taxation Enquiry Committee, para 75.

<sup>2</sup> Punjab Land Revenue Committee Report, para 8.

<sup>3</sup> Report of the Indian Taxation Enquiry Committee, Vol. II, Appendix V.

ing to the natural and other advantages that the tracts enjoyed, the task is so difficult that it has been attempted nowhere in the world. To expect that the right way of taxing economic rent would be evolved by the simple method of leaving the task of determining the rates and sometimes even the basis to the settlement officers<sup>1</sup> was an instance of childish credulity, which only a government in India could have been guilty of. Other countries have always been content with laying down a low flat rate. This is practicable even here. If the present high rates have, however, to be maintained, the U.P. practice of laying down a ratio, which cannot be widely departed from without pointing out special circumstances, ought to be adopted. A system as in Bombay of laying down only a maximum ratio and the number of circumstances that should be taken into account in fixing the tax below this is in our opinion inadvisable.

(ii) **Rates—Present and Proposed:** As to the actual rates prevailing today, we have little information. The different dates of settlement, the different rules in force at those times, the great discretion given to revenue officers and the rules regarding enhancement and improvement make a precise answer very difficult. The Indian Taxation Enquiry Committee made an effort in that direction, but the response, as we have seen, was discouraging. The C.P. Government expressed inability to give reliable figures. The Punjab Government gave figures<sup>2</sup> only for eleven recently settled districts, where the average rate before settlement was 17.8 per cent and after settlement 25 per cent. In U.P., the average rate of revenue to rentals' value was 27 per cent. In Bombay the ratio varied widely from 17.1 per cent to 50 per cent and in Madras from 6.25 per cent to 24.1 per cent. The Indian Taxation Enquiry Committee, exasperated at these results, recommended an "expert inquiry in each province with a view of ascertaining what is the most general rate at present exacted."<sup>3</sup> So

1 Land Revenue Policy of the Indian Government, para 39.

2 Report of the Indian Taxation Enquiry Committee, para 94.

3 *Ibid.*, para 103.

far no such inquiry has been instituted. Though recent legislation in provinces must have led to more uniform rates in tracts, where re-settlement has taken place after the legislation, the exact change affected is not known. Whatever the detailed results of the contemplated inquiry may be, there is no doubt that the present rate would be found in many cases to exceed 25 per cent of the annual value which the Taxation Committee<sup>1</sup> and the Bombay Land Revenue Assessment Committee<sup>2</sup> recommended. Personally, we think that the rate ought to be fixed much lower. A rate of 10 per cent will be quite suitable.<sup>3</sup>

(iii) **Exemption of Small Farms:** Of recent years, a demand for exemption of owners of small farms from payment of land revenue has gathered strength. In principle, we do not think anything can be said against it.<sup>4</sup> The poor cultivator, who just manages to keep his body and soul together, deserves to be exempted both on humanitarian and scientific grounds. But administratively such a proposal may mean great difficulties.<sup>5</sup> Moreover, if we fix a small rate, revenue payment will not mean any great hardship even to small farmers. The need for greater revenue for financing developmental expenditure must also be borne in mind. We, therefore, think that it will be better to tax all farms under our proposed system, and grant no exemptions. If, however, the rate continues to be high, the plea for exemption of small farms is unanswerable, and no administrative difficulties ought to be allowed to stand in the way.

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1 Report of the Indian Taxation Enquiry Committee, para 105.

2 Report, para 30.

3 This, as well as many of our other recommendations, are on the general supposition that agricultural incomes will be liable to income tax. In case the present high agricultural prices continue, the lowering of the rate would be automatically achieved.

4 Some of the objections raised against the proposal are surprising. A great revenue expert holds the opinion that exemption may be resented to by persons exempted, for it would mean a loss of prestige (Punjab L. R. R., p. 161). There is the further argument that such a procedure will lead to greater uneconomic holdings (I. T. E. C., para 96, Punjab L. R. R., para 156). Such funny arguments it is no need to rebut.

5 Report of the Punjab Land Revenue Committee, paras 155, 157 and 158.

(iv) **Progression in Land Revenue:** There is also another demand made on the income-tax analogy, viz., the introduction of progressive rates. If the rate is kept as low as in other countries, the great difficulties attendant on such a system had better been avoided. In other countries also, no progression is found in this tax. However, if we choose to have high rates the case for some sort of progression in rates is undeniable. Even the Punjab Land Revenue Committee, vehemently opposed to the introduction of income tax principles in land revenue system, recommended that in future settlements the owner-cultivators paying not more than Rs. 25 land revenue should be charged at three-fourth of the standard rate.<sup>1</sup> Their temporary proposals went further in the direction of progression. A reduction of 50 per cent for all owner-cultivators paying land revenue upto Rs. 10, and a flat reduction of Rs. 5 for those paying between Rs. 10 and Rs. 25 was recommended.<sup>2</sup> For higher incomes, the Committee suggested the imposition of a temporary surcharge, beginning with  $6\frac{1}{4}$  per cent for those paying land revenue between Rs. 250 and Rs. 500, and ending with 25 per cent on those paying more than Rs. 5,000.<sup>3</sup> U.P. has adopted even more radical measures in this direction.<sup>4</sup>

#### (c) Period of Revision

Whatever basis and whatever rates we adopt, in actual working much will depend on the length of the settlement. If the settlement is for an unduly long period, the justice of the original basis and rate can contribute little to an equitable system, for soon they will get out of date. At the same time, the great trouble and expenses involved in connection with settlement operations rule out any approximation to the annual income tax basis. Some compromise is, therefore, essential. In India before 1921, thirty years were usually held to be the most desirable period. In the Punjab and C.P., however, twenty years were the

<sup>1</sup> Report of the Punjab Land Revenue Committee, para 129. The concession is confined to only cultivator-owners. It is laid down in terms of land revenue, for that is the surest practical guide.

<sup>2</sup> *Ibid.*, para 134.

<sup>3</sup> *Ibid.*, para 166.

<sup>4</sup> *Ibid.*, paras 130 and 173.

general rule. In the backward tracts still shorter periods were adopted.<sup>1</sup> This was desirable, because in such tracts there were possibilities of radical changes in short times. With the advent of the Montague-Chelmsford reforms, there was a demand for a longer period of settlement from many quarters, and both in the Punjab (except new canal irrigated areas) and U.P. the period was raised to 40 years. The recent Bombay Act, however, prescribes a revision of the settlement after thirty years. Thirty years except under very special circumstances should be the maximum duration for the currency of a settlement. Even this period is rather long, and attempts must be made to see whether the period can be further reduced.

#### (d) Elasticity

However short the duration of a settlement, and whatever the number of previous years taken into account to calculate a fair rent, it is certain that it will mean great hardship in certain cases. Even if the conditions in the following period are on the whole similar to those which have been taken into account in fixing demands, there are bound to be some years in the period, when there may be a severe famine, flood or drought. It is little consolation to the hard-pressed farmer to tell him at such a time that though that year he may pay a very heavy tax on his income, over a series of years he would be paying only a small percentage. The past years' surplus income he has probably spent; the future surpluses are yet to come. To meet this contingency, remissions in case of an ordinary calamity and suspensions in case of an extraordinary one are essential. While this is recognised in Government land revenue policy in theory,<sup>2</sup> there is an all round complaint that the present way of administering them is tardy and inadequate. A sympathetic executive will do much to remove this complaint. But systems providing for automatic adjustment will be much better.

1 Land Revenue Policy of the Indian Government, para 18.

2 *Ibid.*, para 38.

**Fixed versus Fluctuating Demands:** In case of irrigated lands, the problem has been long ago partially provided for, notably in Madras and the Punjab.<sup>1</sup> In Madras, no revenue is charged upon irrigable land the produce of which has not matured owing to failure of water supply. The Punjab goes further, and allows a proportionate abatement of the assessment rate for every deficiency of produce. In Assam, the same rule as in Madras is followed even with regard to unirrigated lands, no revenue being demanded on acres unsown. While a provision on Madras lines could be profitably inserted in case of every province, the provision applying to parts of the Punjab and that in Assam require so elaborate an inspection, that they should be prescribed only in a province or tract, where great and frequent fluctuations are likely.<sup>2</sup> In other cases, discretion to the executive to reduce demand is all that can be done.

**Price Changes:** The experience of the last depression has made us think of one more factor which calls for providing a great elasticity in land revenue demand if the farmer is not to be ruined; and this is the factor of prices. Upto 1929, we had assumed that the only direction in which prices could, on the average, change was upward, so that the only effect of price changes on a fixed land revenue demand was to slowly lower it. The Great Depression made us realise another possibility. By 1933 prices of agricultural commodities had fallen by about 50 per cent so that the gross income of the cultivator had been reduced to half. The costs of cultivation decreased by a smaller percentage, so that the net incomes of the farmers fell by more than 50 per cent.<sup>3</sup> The result was that land revenue demands, never unoppressive, became exorbitant.<sup>4</sup> The provincial governments did not rise to the occasion and granted only niggardly reliefs.<sup>5</sup> The farmers were ruined as

<sup>1</sup> Land Revenue Policy of the Indian Government, para 36.

<sup>2</sup> For a discussion of the relative merits, see Report of the Punjab Land Revenue Committee, para 108.

<sup>3</sup> For some interesting figures, see *Ibid.*, page 141, para 23.

<sup>4</sup> *Ibid.*, pp. 136-7, para 15.

<sup>5</sup> The land revenue collections in 1932-33 were only 4 per cent less than those in 1929-30.

a result. To meet such a situation, a new system has been devised in the Punjab. With a view to provide for some sort of automatic relief when prices fall, land revenue demand computed according to usual rules is laid down as the maximum, but it is not to be paid in full unless the general price level of the chief staple products of the district during the two preceding seasons is as high as the commutation price level. For every fall in price level below this, a proportionate remission is granted, the unit being half an anna per rupee.<sup>1</sup> This arrangement has won great popularity, among the ryots. The Punjab Land Revenue Committee suggested some further changes to improve this system. (a) Under the present system, since the maximum has been laid down, there is a tendency among settlement officers to fix commutation prices much higher than current prices. This makes the initial land revenue demand appear unduly high in the first instance, and is likely to create misunderstanding. Of course, the actual working of the system will convince the ryots of its good intentions, and then the system will appeal to them, for it works by way of remissions. Nonetheless, the initial unfavourable impression is a great impediment. The Committee, therefore, pleaded for fixing the initial land revenue demand on the basis of prices during the last four or five normal years: the maximum was to be calculated on the same rules as before. The actual land revenue demand any year was to be determined from the initial demand according to price reductions or rises, but in no case the demand was to exceed the maximum. Thus, the initial land revenue being fixed low, land revenue demand will not have to be disturbed often and the farmers would not be frightened by unnecessarily high figures. The widespread apprehension, that the introduction of such a novel feature into our land revenue system, whereby the initial demand could not only be lowered but also raised, may lead to its unpopularity, was pointed out to the Committee. But they thought that the system was bound to gain acceptance by its obvious logic and fairness.<sup>2</sup>

<sup>1</sup> Report of the Punjab Land Revenue Committee, para 87.

<sup>2</sup> *Ibid.*, paras 02-04.

(b) The remissions under the present system are based on the prices of the past two years. This is a grave defect in a scheme, whose object is to provide for an automatic adjustment of land revenue payment to falls in annual income. The defect would be felt as a much greater hardship under the system proposed by the Committee, where not only reduction in, but also enhancement of, land revenue demand were provided for. The Committee, therefore, made certain recommendations to bring the demand more in line with current prices without unduly postponing the time of collection. They also suggested a proper weighting of daily prices according to the quantity of the produce sold each day.<sup>1</sup> (c) The Committee provided for a proportionate reduction in terms of half an anna, but it was not to begin until there was a price fall of at least 12½ per cent.<sup>2</sup> Since the Committee's scheme was based upon an initially low demand, they had also to provide for enhancements. The effect of a rise in prices on the farmer depends on the amount of his sales relative to that of his purchases, and the proportion on his other income, e.g. remittances from abroad bears to his farming income. The effect of a rise in prices may not, therefore, be always beneficial, and the advantages, where any, may not be proportionate to the price rise. In general, the more substantial farmer only is likely to gain much from a price rise.<sup>3</sup> The Committee, therefore, provided for an enhancement only at a much later stage, i.e., when prices rose by 25 per cent. The unit proposed was larger, one anna, and the enhancement was not to be proportionate to the price rise, but only fifty per cent of the rise.<sup>4</sup> Moreover, as we have already seen, while no limit to reduction was laid down, a limit to enhancement was already fixed. This new system would certainly be more suitable to congested areas where there was much small-scale farming. In other areas, perhaps, the present system may be found more suitable. The application of these two alternative plans should be decided in

<sup>1</sup> Report of the Punjab Land Revenue Committee, paras 100, 101 and 103.

<sup>2</sup> *Ibid.*, paras 95-96.

<sup>3</sup> *Ibid.*, para 97.

<sup>4</sup> *Ibid.*, para 96.

each case on its own merits, and a careful review should be made after seeing the working.<sup>1</sup>

The recent Bombay Land Revenue Amendment Act also provides for some adjustment in case of change in prices. Future settlement are to be based with reference to prices of certain staple commodities, and the Government have the right to give a rebate in case of a fall or levy a surcharge in case of a rise of prices. The right of surcharge was essential, because the maximum of land revenue demand for a group has been fixed at 35 per cent of the averages of rental values for the period of last five years. It is quite likely that current rental value might prove quite low. As for the right to grant a rebate, nobody has disputed it. In fact, it is a recognized duty. What was wanted was some automatic scheme which would ensure a reduction when prices fell. Unfortunately no such scheme has been laid down.

It is urgently essential that in all the provinces, some scheme on the Punjab line or still better on the lines laid down by the Punjab Land Revenue Committee should be adopted,<sup>2</sup> whereby some sort of adjustment to rise<sup>3</sup> or fall in prices is ensured. The exact lines of the schemes will have to vary with the conditions in each province, perhaps even with tracts in each province, and may have to be revised in light of experience afterwards. But a beginning certainly ought to be made.

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1 Report of the Punjab Land Revenue Committee, para 99.

2 We have seen that there is a time lag between a fall in the gross income and the cost of production, so that a remission given proportionately to fall in gross income is inadequate. This is specially so, when the commutation prices have purposely been fixed too high to save a loss of revenue. While it is true that the lag between a change in gross income from agriculture and that in costs of cultivation is both ways the upward swing advantage is not likely under the present sliding scale system. Even under a two-limit system proposed by the Committee, though the lag in the upper swing may compensate for a lag in the downward trend, neutralization will take place only over a long period and in the meantime the system may lead to much confusion. However, since the initial demand is kept low, and the necessity of reduction thereby lessened, it may be hoped that this would not matter much.

3 Under neither of these systems, a price rise on the present scale could be allowed for, but this is only a wartime phenomenon, unlikely to be repeated in normal times.

### (e) The Limit of Enhancement

Various provinces have thought fit either by statute or executive rules to lay down some limit to the enhancement that can be made in the original demands on a resettlement. Madras executive orders, for example, provide that no enhancement if made to cover rise in prices shall exceed 18½ per cent. The 1929 C.P. Act lays down that enhancement shall be limited, in case of individual holdings to 75 per cent, of a mahal to 50 per cent, and of a group to 33 per cent. In U.P. also a similar provision was made, the enhancement being limited to 33½ per cent with the proviso that land revenue demand was not to exceed 30 per cent of net assets. In Bombay upto the passing of the recent law, there was no legislation on the matter, but by executive orders the limits at the time of the appointment of the Bombay Land Revenue Assessment Committee were 100 per cent for individual holdings, 66 per cent for a village, and 33 per cent for a group of villages. The Committee recommended that the limit should be fixed at 25 per cent all round in case of talukas already revised second time.<sup>1</sup> The recent Act, however, maintains the distinction between a single holding and a taluka, but prescribes lower limits of increase, viz., 50 per cent and 25 per cent respectively. In the Punjab, no such principle is in force.

To our mind, the fixation of enhancement is wrong in principle. When the land revenue demand was very high and it was thought that resettlement always meant enhancement, such legislation ensured that too much would not be exacted from farmers and that in the long period the original high rate would be tempered down without any revolutionary change in rate rules. Where, however, the rate and the basis are laid down by statute, and where the rate is low, such a limit has little uses. In the past, these rules regarding enhancement did not lead to much inequity because agricultural development and improvement were

<sup>1</sup> Report, para 41. In case of lands not revised, since the original settlement had been done on different principles by different officers, in order to make for greater uniformity the previous limits of enhancement were to continue.

slow. But in an era of rapid development to which we now look forward, the provision would mean a great inequity among different landlords and an undeserved concession to them at the expense of the general taxpayers. The rise in prices may also necessitate the abolition of these enhancement limits.

While there is no reason, in our opinion, as to why enhancement should be limited, there are good reasons to make the increase in demand a slow process. The sudden enhancement of land revenue may mean a great disturbance in the standard of life a farmer might have accustomed himself to. It is true that he ought to have seen in advance that the rise in his income was bound to result in a higher demand on him at the time of settlement, and should have therefore from the beginning made adequate provision for it. Things, however, seldom proceed so logically, and least of all with the farmer. It is, therefore, advisable for the state to obviate the great difficulties he might have to undergo by graduating the enhancement. This problem was early recognized, and provisions were made in some provinces to deal with the problem.<sup>1</sup> The old Madras Revenue Code provided for 25 per cent as the maximum enhancement which might be imposed at once, the balance being imposed by annual instalments not exceeding 12½ per cent of the original assessment. With the low rate that we have advocated, the possibilities of a disturbance in the accustomed standard of life due to sudden enhancements becomes much less. Yet, for very high rates of enhancement, some such provision may be made.

#### (f) Treatment of Improvements

The question of the treatment of increases in income due to private improvements is a vexed one. While it is fairly clear to all that the rise in income due to good fortune or due to public improvements should be taxed, many have pleaded for the exemption from taxation of private improvements in agriculture. Some Provinces have com-

<sup>1</sup> Land Revenue Policy of the Indian Government, paras 33-34.

plied with this demand in various ways.<sup>1</sup> To our mind, any permanent exemption as given by the original Bombay Land Revenue Code and recommended by the Bombay Committee seems to be fundamentally wrong.<sup>2</sup> In other fields, we never think of exempting profits from private improvements, and there is no reason why we should give such a preferential treatment to income from land. The only purpose of such a proposal can be to ensure an adequate and fair return to the farmer from the expenditure on improvements. In absence of an adequate depreciation allowance system in the determination of land revenue, it may be argued that this proposal alone can yield this result. This is too far-fetched. The utmost that can be done in this matter is to exempt improvements for over a certain period, e.g. as in Bombay for 30 years. Still better, various periods for different types of improvement may be laid down as done in some parts today.<sup>3</sup> A tax on agricultural incomes that we have pleaded for, either by itself or as a part of the general income tax, will necessitate an estimate of the duration of every improvement and this may be utilized in our land revenue taxation also. Any concession beyond this is to our mind unfair to others, and may in course of time lead to great inequity among the landholders themselves.

### Conclusion

Thus, we have seen that the present land revenue system in India is a great anachronism. The permanent determination of land revenue for a considerable part of India, an entire absence of clarification in various provinces regarding the basis and the rate, an unprecedented amount of discretion to the executive, a facile belief that all the great difficulties inherent in the nature of a tax on land can be solved by the simple process of giving unfettered powers to officers, a queer treatment of private

<sup>1</sup> Land Revenue Policy of the Indian Government, para 20.

<sup>2</sup> Report, para 43.

<sup>3</sup> Land Revenue Policy of the Indian Government, para 20.

improvements and limits regarding enhancements, these have been the besetting sins of the land revenue system in India. The dyarchy of Montague-Chelmsford reforms led to some good changes; the advent of the Provincial Autonomy meant some more improvements. What is needed, however, is an entire overhauling of the system on modern lines with an income tax on agricultural incomes, and a flat low rate on landholders. This is nowhere yet in sight.

## CHAPTER VII

### TAXES ON GOODS AND SERVICES

#### A General Sales Tax

##### I. Introduction

We have assumed so far, that income can furnish the best criterion of a person's ability to pay taxes, or of the sacrifice that he undergoes in paying them. Persons have, however, not been wanting, who have regarded expenditure as the real test. They have vigorously argued that the ability of a person is measured by the value of the goods and services he has actually consumed, and not by the power over them which he could have utilized but much of which he may choose not to exercise.<sup>1</sup> This view has recently been losing ground,<sup>2</sup> and it is being increasingly recognized that savings constitute as important a part of one's ability as spending. But the less adverse effects on production that an expenditure tax has as contrasted with an income tax, and the fear that an income tax means a double taxation of savings<sup>3</sup> have attracted many to the idea of taxing expenses. Various schemes have been put forth to embody this idea.<sup>4</sup> The greatest approximation to it in

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1 "A man is actually and truly rich according to what he eateth, drinketh, weareth, or in any other way really and actually enjoyeth;" and that, therefore, "every one ought to contribute according to what he taketh to himself and actually enjoyeth". William Petty, quoted in Weston, p. 278.

2 The view has still some supporters. For instance, Irving Fisher defines "Income" as money spent, for money is "of no use to us until it is spent". Quoted in Jacoby—Retail Sales Taxation, p. 93. See also his article "Income in the Theory and Income Taxation in Practice" in Econometrica, 1937.

3 *Vide* Pigu, A Study of Public Finance, p. 136.

4 The most notable has been the Mills Spendings Tax proposed by Ogden L. Mills of New York. In his scheme, a progressive rate varying from 1 to 40 per cent was to be laid on various spending classes. An exemption of \$2,000 was to be allowed to single persons, and of \$4,000 to heads of families. Business expenses, insurance premiums, funeral expenses, charitable gifts, etc. were to be excluded. Buehler, General Sales Taxation, pp. 17-18.

the practice of taxation has been what goes under the name of "General Sales Taxation." Let us, therefore, examine carefully how far the ideal expenditure tax and the general sales tax fulfill the requirements of justice.

## II. Defects of the General Sales Tax

### (a) Its Regressiveness

1 A general sales tax, in its all-embracing form, is a regressive tax. The budget studies of all the countries of the world including the few in India have shown that the greater a person's income, the less the proportion of it that he spends and the greater the percentage that he saves. At the very bottom of the social ladder are men, whose incomes are so meagre that all their efforts to live within their means are foredoomed to failure. They spend more than they earn. At the top there are persons, who, in spite of the ever-increasing number of conventional necessities, comforts and luxuries that they have found essential as their class has gone back from the early habits of puritanism to those of extravagant feudalism, cannot but save a great proportion of what they earn. Between these two stand a great variety of income-groups, where personal habits count much, but where usually the higher we go, the lower the proportion of expenditure to income. It is quite possible to think of appropriate progressive rates on expenditure that may adequately compensate for this tendency, and even make for progression.<sup>1</sup> But on administrative grounds, as these taxes have to be collected from dealers, the best tax that we can look forward to is a proportionate tax on all expenditure items; and this will be a greatly regressive tax with no exemption level.

### (b) Discrimination against Families

In Chapter I we have seen, that other things being equal, the greater the size of a person's family the less his

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<sup>1</sup> To achieve the present progression, the sales tax on higher incomes will have to be much higher than the present income tax rates.

capacity to pay taxes. A general sales tax can take no account of this reduced capacity.<sup>1</sup> On the other hand, it hits married and family persons harder.<sup>2</sup> The greater the size of the family, the more the expenses that have to be incurred on food, clothing, shelter and other necessaries. The expenditure on luxuries and comforts is also likely to increase with the number of persons in one's family. It may be that in many cases the blessings of matrimony, especially when followed by the torches of Hymen, induce such a feeling of responsibility and such care in household expenses, that a family man actually spends less than the care-free happy-go-lucky bachelor of the same income. But this is only likely to be true, when we pass the realm of necessity, and even then we cannot assume that this factor will be sufficiently powerful to make up for the lack of a system of family allowances.

**(c) No Differentiation between Earned and Unearned Incomes**

The differentiation in favour of earned income has come to be recognized as an essential feature of a modern tax system.<sup>3</sup> A general sales tax cannot make this differentiation. It treats earned and unearned incomes on the same basis.

**(d) Exemption of Services and Public Utilities**

So far, we have thought of a general sales tax imposed at the same rate on sales of all commodities and services. Due to various reasons, however, the sales taxes found in many countries exclude some of these items. Often the general sales tax is a tax only on transactions in "tangible personal property," and excludes all services. Australia, Canada, Brazil, Austria, Belgium, Italy and many other countries exempt services entirely.<sup>1</sup> The recent Sales Acts in Indian Provinces follow the example of these countries.<sup>2</sup> Even where services are included in the scope of

<sup>1</sup> Buehler, p. 150.

<sup>2</sup> Under the 1935 constitution the provinces have no power to tax services.

the tax, the receipts of certain services are excluded, e.g., in France the gross receipts of professionals, the wages and the salaries were not taxed.<sup>1</sup> Public utility services are not taxable also in Belgium and Italy.<sup>2</sup> In U.S.A. States, expense on residential housing, rewards for professional and the bulk of non-professional services, and the salaries of domestic servants are often excluded.<sup>3</sup> The richer persons spend a greater proportion of their expenses in payment of salaries to domestic servants, fees, and rent and transport charges.<sup>4</sup> An exemption of these, therefore, means an inability to tax the upper income groups even in proportion to their expenses. This means regressive taxation even when judged from the spending criterion. |

#### (e) Double Taxation

The general sales tax in its best form is imposed at one stage, either at manufacture stage as in Canada, or at retail stage as in U.S.A. States. | Even then, its burden is likely to vary. One and the same commodity may be in itself a source of ultimate satisfaction, and a raw material or intermediate good. Such a commodity is likely to be taxed twice. | Fuel, for example, may serve either for household cooking purposes or for industrial uses. When used for industrial purposes, it will pay a double tax.<sup>5</sup> This double taxation of the raw materials or intermediate goods, once in their own capacity, and the other in their embodiment into the final consumers' goods, is highly objectionable. Various rules like the "physical ingredient" rule<sup>6</sup> or the refund of the tax on commodities bought for use directly in processing operations are used to retrieve the situation, but they cannot prevent the injustice entirely. | Under the rule of "physical ingredient", for example, the cotton to be used in making clothes will not be taxed twice, but the fuel

1 Shoup—*The Sales Tax in France*, p. 220.

2 Buchler, p. 151.

3 Jacoby, p. 104.

4 For some very interesting figures as to the percentage spent on tangible personal property by different classes, see Jacoby, p. 101. The expenses decrease from 60.9 per cent to 1 per cent; see also p. 198.

5 For the meaning of this rule, see Jacoby, p. 180.

will be. / The refund expedient, while making a considerable improvement on the "physical ingredient" rule, cannot provide for the exemption of stationery, the motor trucks, etc. used for business purposes.<sup>1</sup> When the tax is levied at the wholesale or production stage, much of the hardship can be alleviated by adopting a rule on Canadian lines,<sup>2</sup> providing that the tax will not be laid on goods sold to licensed manufacturers or producers, or upon goods imported by them to be used in the manufacture of taxed articles.

But, very often, things are much worse. The general sales tax is frequently enough a sort of turnover tax imposed at every stage of sales.<sup>3</sup> Every time a commodity changes hands, it has to suffer the tax ordeal. All commodities do not undergo an equal number of transfers.<sup>4</sup> Expenses in some directions are, therefore, taxed at a higher rate than those in others, and since services are usually non-transferable, expenditure on these will be taxed at smaller rates. /

### Devices to Reduce Regressiveness

To remove the great regressiveness of the tax on spendings, two main remedies are usually adopted.

1 For the whole controversy, see Jaeger, pp. 129-180. He calculates the proportion of taxed sales to retail sales for different States and arrives thus at the extent of "double taxation" in U. S. A. States. For Illinois the ratio of taxed transactions to retail sales is as high as 158.8 per cent (p. 176).

2 Buehler, p. 110.

3 This is mainly due to the desire to conceal the actual rate of the tax, and to prevent the great harm that a tax with a high rate may do to business when not shifted.

4 The following figures from an American tax pamphlet "The Primer" are interesting :

Article.	Taxable Stages.
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Sugar	..	4
Bread	..	3
\$40 suit on men's clothing	..	7
87 pairs of men's shoes	..	6
\$85.1 cord tire	..	11

Quoted in Buehler, p. 204. Dr. Naidu and Mr. Thiruvengadathan have made a commendable effort to study the taxable stages of various commodities in Madras Province. *Vide* the Madras General Sales Tax Act, p. 75.

(a) **Exemption of Necessaries:** It is customary in countries, where some regard for justice in taxation is maintained, to exempt certain necessities from the sales tax.<sup>1</sup> The most frequently exempted necessities are essential food items.<sup>2</sup> Even they, however, are more often subject to the sales tax. In U.S.A. States, for example, only in five out of twenty-four States having sales tax, essential food was entirely exempt from taxation.<sup>3</sup> The list of exempt necessities can be much widened as in Canada.<sup>2</sup> Since the lower the income group, the greater the proportion of income it spends on necessities, this exemption system reduces the regressiveness of a spendings tax, especially in the lower income groups. But owing to the exigencies of administration and the paramount need of the government for revenue, this list of exemptions cannot be carried far. Even when strained to its utmost limits, it is hardly able to counteract the effects of the widespread exemption of services.<sup>3</sup>

(b) **Heavier Taxation of Luxuries:** A more powerful instrument, which has greater appeal to the State as it is a revenue-yielding measure, is the taxation of luxuries at higher rates. Since the lower income groups spend next to nothing on them, the middle classes only a small proportion, and the richer classes a high proportion, a higher sales tax on them, it may be felt, will do much to compensate for the grave regressiveness of a general sales tax. But there are great obstacles in the way.<sup>1</sup> The demand for luxuries is, in general, elastic, and a great increase in rates may yield diminishing returns.<sup>2</sup> The definition of luxuries is an extremely difficult task. There are some commodities, which can be immediately classed as luxuries, e.g., silk clothes; a higher rate on them is an easy possibility. But, in all cases the sailing is not so smooth. Many commodities are luxuries only when bought in great quanti-

<sup>1</sup> Jacoby, p. 104.

<sup>2</sup> Canada exempts almost all prime necessities. For a full list, see Buchler, pp. 117-119.

<sup>3</sup> Only 5 States in U. S. A. tax professional services, 6 non-professional, 9 hotel and lodging, and 11 transportation services.—Jacoby, p. 104.

ties; to tax this type of luxuries is, obviously, impracticable, though sometimes an attempt is made to do so by taxing individual transactions above a certain sum at a higher rate.<sup>1</sup> This heavier tax can be easily avoided by splitting up the buying. Some commodities are only luxuries, when they belong to higher varieties in their class. For example, a watch is used by every worker in many countries, but only the rich use a watch costing more than a certain sum. Provision, therefore, is made in the tax laws of some countries to tax such commodities at higher rates when they cost above a certain sum per unit.<sup>2</sup> This involves great administrative trouble. With every general price change, the prices beyond which the commodities become luxuries have to be changed. These difficulties have made some countries give up the attempt to tax luxuries at higher rates.<sup>3</sup> Others have persisted, but the results have not been encouraging and the tax has been far from effective.<sup>4</sup> Even in France, which has the most well-developed system of luxury taxation, the revenue realised has been meagre.<sup>5</sup>

Thus, we have as yet devised no effective means to reduce the regressiveness of a general sales tax.

### III. Incidence of a General Sales Tax

We have so far assumed that a sales tax is shifted onwards to the final consumer. While, in the main, this remains true, there are various factors, which may hamper

<sup>1</sup> In Belgium, e.g., sales below 30 francs are exempted. The 1917 law in France taxed all retail sales over 150 francs at 2 per cent.—Buehler, p. 185, Green, p. 173. The 1923 law in Italy taxed all transactions below 100 lire at a lower rate—Buehler, p. 182.

<sup>2</sup> In France, certain commodities are considered *de luxe* because of their nature, others are luxury goods only when sold above a certain price. In addition, all hotels are classified as luxurious, semi-luxurious and ordinary, and different rates are levied on them.—Shoup, pp. 157-179.

<sup>3</sup> Germany, for example, gave up luxury taxation after 1926.—Buehler p. 106.

<sup>4</sup> Cf. "I see, usually once or twice a year the heads of the tax systems of the important nations of the world, and I find one thing universal—that they all think that sales tax is practical, and they all think a luxury tax is an abomination".—Dr. Adams quoted in Green, p. 195.

<sup>5</sup> In 1934, the tax on luxuries including surtaxes yielded only 234 million francs, while the general turnover tax returned 6151 million francs.—Green, p. 175.

the course of the transfer especially in the short run. Since this means a great difference to the justice of a sales tax, it is worth our while to examine the question in detail.

### Sales Tax on a Commodity

The problem of the incidence of a general sales tax is better examined by first taking up the question of a tax on a single commodity. We will, then, pass on to discuss the various qualifications that should be introduced in order to apply the conclusion so arrived at to the general sales tax.

**(a) Elasticity of Demand:** The most important circumstances deciding the incidence of a tax are the elasticity of its demand and supply. Where the demand is elastic, any attempt of the seller to pass the tax to consumer will bring about a great shrinkage in the demand for that commodity. The merchant or the producer may have soon to retrace his steps, and wait until the time when the stocks and supply have sufficiently diminished. The more elastic the demand, the greater the adjustment that will have to be made in supply, and the more difficult and delayed the process of shifting. The demand for comforts and goods for which easy substitutes can be found is of this type, so that a tax on them will be hard to shift. On the other hand, the demand for necessities and extreme luxuries is inelastic. A rise in their prices will not be followed by a great fall in demand. The adjustment of supply to the new demand will be easily achieved and the tax passed on.

**(b) Elasticity of Supply:** A rise in prices consequent on the tax is bound, in case of most of the commodities, to bring about some reduction in demand. The former supply can no longer be absorbed at the increased price. There must be, therefore, a decrease in the production of the taxed commodity, if the consumer is to be made to bear the tax burden. The greater the elasticity of supply, the quicker the shifting will be. To the extent that land plays an important part in the production of any commodity,

elasticity of supply will not be possible. On rent will be the first impact of the tax. But when it is insufficient to absorb the whole tax, labour and capital employed in the production of that commodity will have to bear it, unless a portion of them is transferred to other spheres. The specialization of labour and the fixed plant of an industry are grave obstacles to this transfer. The raising up of the demand curve that generally follows in the wake of progress, the absence of replacement of depreciated machinery, and the stopping of new labour recruits will in course of time bring about the necessary adjustment. But the time taken for this adjustment may be long, especially when the commodity is a durable<sup>1</sup> one, and the demand for it is elastic.

**(c) Law of Returns:** The law of costs, to which the commodity at its present state of production is subject, decides to a great extent the ease and the time taken in shifting the tax. Where the commodity obeys the law of decreasing costs, any effort to withhold a part of production will mean a rise in costs, a further need to raise prices, and the necessity for a further curtailment of production. Where, however, the commodity is produced under conditions of diminishing returns, the necessary price fall will be by an amount less than the tax rate; the decrease in demand will, therefore, be less, and the adjustment needed will be small. The shifting of the tax will, thus, be easier. The case of a commodity subject to the law of constant returns will stand midway between the two.

**(d) Competition and Monopoly:** If the commodity is produced under conditions of perfect competition, it is comparatively easy to lay down the circumstances under which the shifting will take place. Where, however, monopoly prevails, it is impossible to be sure of the incidence without having detailed data. A proportionate tax on the produce increases the costs of production even for the monopolist. But unlike the marginal producer under com-

<sup>1</sup> We have not discussed here the case of capitalization likely to occur, when the commodity taxed is durable. This has been already discussed in Chapter II.

petitive conditions, he is under no compelling necessity to raise prices which, in his case, are greater than the marginal cost. The monopolist will have to make a guess as to which course will bring him the maximum monopoly revenue, the maintenance of prices at the same rate, or an increase in them. Both the possibilities are equal<sup>1</sup> and it is hard to say anything general about it.

(e) **Proportionate and Progressive Rates:** The nature of the tax has an important share in deciding the shifting. The market price, as we have seen, is determined by the marginal cost of production.<sup>1</sup> It is only when the marginal product is taxed at the same rate as other products, that the shifting is assured.<sup>1</sup> In a tax on a commodity, usually the rate is uniform, and no exemptions are given, so that there is no hindrance in the passing on of the tax. But sometimes there are exemptions of a part of the produce, and even progressive rates, which make shifting very difficult.

(f) **Rate of the Tax:** [The heavier the tax, the greater the pains and the risks which a trader will take to ensure the shifting; the smaller the tax, the less the likelihood that he will make up his mind to face the keen resentment of the customers attendant on a price rise, or that he will put forth powerful efforts to organize with his colleagues to see that the tax is shifted.<sup>1</sup> Hence, there are more chances of a high rate of tax being shifted, and of a low rate resting only where placed.<sup>2</sup> However if the tax is too heavy, the great fall in demand consequent on a price rise by the full amount of the tax will make the heavy rate a hindrance rather than a help to shifting.

(g) **Miscellaneous Factors:** There are various other small factors, which play a role in deciding the shifting of the tax, and which we may note in passing. It is harder to shift a tax on low-valued commodities than on high-valued ones.<sup>3</sup> Articles with well-known and psychological prices

present special difficulties. { An attempt to shift a tax on them by a rise in their price is bound to give rise to great resentment among customers and therefore likely to fail. The easy way of shifting the tax on such commodities is through a deterioration in quality or a reduction in standard size. } The wholesalers or producers, because of their organization and the greater knowledge among their customers, find it easier to shift the tax than the retailers.<sup>1</sup> It is very difficult for retailers in a poor locality to pass the tax on to the consumers. The general business conditions also play a role in deciding where the tax will rest.<sup>2</sup> Where the prices are falling, the shifting is fraught with many difficulties. Where, however, the times are propitious, shifting is a much easier process. The nature of the commodity taxed will also be important in determining shifting. { A tax on raw materials or capital goods will not be easily shifted onwards to final consumers. }

Thus, the task of passing over a tax even on individual commodities is not as easy and certain a process, as is oft imagined. These various obstacles to shifting outlined above are bound to lose their force and momentum in course of time. They are only economic frictions, and in the long run the tax is bound to be shifted to the consumers. But in life the short run is as important as the long run. The short run may become so protracted, do so much harm, and even set so many modifying forces in motion, that the long run may only come when we are dead.<sup>3</sup>

### General Sales Tax

(a) **Greater Immobility of Labour and Capital:** The difficulties, which are found in the way of shifting a tax even on individual articles to the consumers, become multiplied when a general sales tax is levied. The tax applies

<sup>1</sup> Haig and Shoup, pp. 360-3, tables 16 and 17; p. 449, table 48; pp. 508-9, tables 90 and 91.

<sup>2</sup> *Ibid.*, p. 327; Buchler, pp. 186-187. It is pertinent to note that the enquiry by Dr. Naidu and Mr. Thiruvengadathan into the Madras General Sales Tax Act brings out the same factors at work.—pp. 71-74.

<sup>3</sup> As is well said, "Economic friction includes everything that is of practical importance"—Nicholson, quoted in Seligman, *Shifting and Incidence of Taxation*, p. 263.

over so large a field, that the taxless fields to repair to are few. The mobility of labour and capital employed in these tasks is, therefore, much less. However, since a general sales tax is not a tax at a uniform rate on the net returns to labour and capital, the different businesses will be unequally hit, and there will be an intermovement, thus facilitating shifting of a great part of the tax. The rest, however, may stick on the producers and dealers.<sup>1</sup>

(b) **Exemption and Progression—(i) Exemption of Small Merchants:** The general sales tax law often contains some exemption or progression, which renders the task of shifting difficult. Like the income tax, most of the tax on gross produce is derived from a comparatively small number of persons, the rest contributing little.<sup>2</sup> Administration and even productivity gain much by exempting this unproductive large number, and concentrating on the few who really count. For this purpose, many countries exempt merchants below a certain level of gross income from the sales tax.<sup>3</sup> Even where there is no legal provision exempting small traders, administrators in the interests of efficiency pay scanty attention to them. If the exempted persons' products form an integral and substantial part of the whole market, this renders the process of shifting doubtful. If, however, the exempted and the taxed merchants form non-competing groups, or if the exempted merchants do not command a considerable part of the trade, the tax will be shifted.

(ii) **Exemption of Farmers:** Usually, farmers are also exempted from a tax on the sales of their produce. Where the farming is small-scale as in many countries, the task of collecting a tax on these is not worthwhile. The

1 The enquiry by Haig and Shoup, however, showed that partial shifting was much less common than we would otherwise suppose. Perhaps, that was due to the short time lag between the imposition of the taxes and the time of the enquiry.

2 In France, when there was no exemption in 1922, 48 per cent of tax-payers contributed little over 2 per cent revenue (Shoup, p. 105). In Germany, in 1926, 68 per cent could have been exempted with only 4 per cent loss in revenue (Fagan and Macy, p. 586).

3 All our recent sales tax acts follow this principle.

farmers form an important political bloc in many countries which politicians dare not displease. Moreover, the farmers were so ill organised and fallen on such evil days, that they would not have been able to shift a tax levied on them. Due to all these reasons, the farm produce sold directly by the farmers is often not subject to the sales tax. This, however, may encourage the elimination of some middlemen, and the remaining of them will not be able to shift the tax.

(iii) **Exemption of Co-operative Societies:** In some countries, due to the natural sympathy for co-operative societies, their sales are exempted from the sales tax.<sup>1</sup> In so far as the co-operative societies sell only to their own members, this may not be considered objectionable. But when the practice is extended to sales to outsiders, it is an obstacle to the shifting. The strength of the obstacle will depend on the place occupied by co-operative sales societies in the marketing organization, and the rapidity with which new ones are likely to crop up.

(iv) **Progressive Rates:** Sometimes, the rates of taxation vary according to the gross income of the seller. U.S.S.R. taxes are the most astounding example of this. Mexico<sup>2</sup> and some U.S.A. States<sup>3</sup> also levy such taxes. This makes shifting of the entire tax difficult.

(v) **Regressive Rates:** A regressive tax also increases the difficulties in shifting the tax. Being much less defensible than a progressive tax, which may be justified on the ground that it is a business tax varying according to the size of the business, it is seldom pleaded for or practised. But considerations of administrative convenience often lead the law-makers to fix a lump sum tax for the lower groups of tax-payers. The desire for revenue may lead to the amount being so fixed, that incomes in the lower ranges of

<sup>1</sup> France follows this practice. Both Bengal and Madras include all sales by co-operative societies to their members within the scope of their sales acts. Madras General Sales Tax Act, Sec. 2 (b), Expt. I, and Bengal Sales Act, 2 (c), Expt. I. The Punjab General Sales Tax Act specifically excludes all sales by co-operative societies. Sec. 5 (1) (a).

<sup>2</sup> Buchler, pp. 228-229.

<sup>3</sup> Haig and Shoup, pp. 41-44.

the group will be taxed at higher rates than the general rate. For instance, the Madras General Sales Tax Act, 1939, laid down a sales tax of  $\frac{1}{2}$  per cent but for dealers between Rs. 10,000 and 20,000, the tax was laid down at Rs. 5 a month, i.e. Rs. 60 a year.<sup>1</sup> Thus, any dealer having a turnover of more than Rs. 10,000 but less than Rs. 12,000 would be taxed at a rate higher than  $\frac{1}{2}$  per cent. Being practised so far only over a small field, this custom had no important consequences; but if spread, it will develop into a serious impediment to shifting.

(c) Inequality between Producers: As we have already seen, in many countries the sales tax is not laid only at one stage but at every change of hands. The number of hands even the same commodity passes through is not uniform, but varies with the size of the business. The products of big vertical trusts may change hands only once or twice, whereas those of their small competitors have to do so many times over. The small producers, thus, will be placed at a grave disadvantage. Unless they have an important role in production, the extra tax on them will not be shifted. This may lead to greater integration of the industry, which will make the task of shifting of those, who still do not combine, very difficult.<sup>2</sup> To guard against this favouritism to big producers, various devices have been adopted. In Germany, by a law of 1918 transfers from one branch of a business to another were to be taxed as if they occurred between two different firms. The task proved too much for the administrative authorities, and the provision was eliminated in 1919.<sup>3</sup> Austria has adopted another intelligent device. On every commodity, a single tax is levied, but the rate varies.<sup>4</sup> It is fixed according to the number of taxable processes the commodity usually undergoes.<sup>4</sup> This needs, however, a very long and detailed classification. In the Austrian list, nearly 400 commodities are mentioned.

1 The changes made in 1940 worsened the position.

2 For the controversy as to how far such a tax promotes integration, see Buchler, pp. 203-209, and Comstock, *Taxation in the Modern State*, pp. 127-128.

3 Comstock, p. 127.

4 Buchler, p. 209.

The measure has achieved a fairly good measure of success, and some other countries are following Austria.<sup>1</sup> But the measure is not likely to be widely adopted. The multi-stage tax is usually dictated by a desire to conceal the rate of the tax, and the anxiety to see that the dealers and manufacturers are not ruined even if the tax sticks on to them. The Austrian device frustrates both these aims.

(d) **Inequitable Distribution among various Commodities:** There is another reason which increases the injustice of a general sales tax. The trader, who pays it, is only interested in seeing that he suffers no loss, or if some loss is inevitable, as little as possible. If he is selling a number of commodities, in transferring the tax burden he will follow the line of least resistance. He will increase the price of certain commodities by more than the amount of the tax, of some by an equal amount, and of others by a less amount or not at all.<sup>2</sup> This is specially likely because the elasticity of demand, the extent to which its price is known, .etc., differ from one commodity to another. In wholesale trade, many of these factors will not be of much importance and the shifting will be uniform. But in retail trades, these factors will exert a great pressure, and the consumers of one commodity will have to pay the tax on another commodity.

#### Steps to Ensure Shifting

(a) **State Measure:** Since the avowed aim of the legislatures in imposing a sales tax is to tax the consumer, and the working of economic laws cannot be relied upon to ensure this, the States of the U.S.A. have adopted various means to facilitate the process of shifting.<sup>3</sup> In almost all the States the retailers are forbidden from advertising, that they are absorbing the tax themselves. Nineteen States specifically require retailers to collect the tax from consumers; fifteen go so far as to prescribe the exact method

1 Buchler, p. 210.

2 Haig and Shoup, p. 383, Table 26; p. 446, Table 27; p. 509, Table 91.

3 Jacoby, pp. 305-309. In Germany, on the contrary, the taxpayer was not permitted to charge the tax separately.—Green, p. 288.

of collection and a few even specify schedules of tax addition. In preparing these schedules, however, a difficulty arises, for the price of every article is not such as to permit an addition precisely equal to the amount of the tax. A tax of 1 per cent on a four anna transaction amounts to 12/25th of a pice; on Rs. 6-8-0 bill it amounts to 1 anna—12/25 pice. In the second case, 1 anna could be easily charged, but what about 12/25th of a pice? The easiest solution of this difficulty is to follow the rule, that any fraction amounting to a half or more than half of the smallest coin should be considered as equal to one whole coin, and a fraction less than half should be neglected. The consumer would not object to such a system, and the dealer could hope that the system would fully compensate him. It may, however, be that the usual transactions of some dealers are such that the above rule would mean some loss to them. In order to alleviate this hardship some States have issued tokens, so that the exact amount of the tax can be shifted.<sup>1</sup>

(b) **Private Measures:** Where the States do not lay down any such rules, the dealers may take similar measures through their associations. They may, for example, lay down that every dealer must show the tax separately in each bill. To facilitate this task they sometimes lay down fixed schedules. Since naturally their great concern would be to prevent any loss to dealers, in cases where the amount of the tax is not an integer, the schedules are likely to err on the dealer's side. For example, in Arizona where the tax is 1½ per cent, the following schedule was adopted by the larger merchants.<sup>2</sup>

Sales	Tax
\$ 0.01 to \$ 0.10	\$ 0.00
\$ 0.11 to \$ 0.80	\$ 0.01
\$ 0.81 to \$ 1.50	\$ 0.02
\$ 1.51 to \$ 2.15	\$ 0.03
\$ 2.16 to \$ 2.80	\$ 0.04
\$ 2.81 to \$ 3.50	\$ 0.05

1 For the year 1937-38, these tokens amounted to about \$296 millions in U.S.A.—Jacoby, p. 311.

2 Haig and Shoup, p. 288.

The tax schedule ought to have been:—No tax for transactions upto 33 cents, for a sale between 33 cents and 1 dollar, 1 cent, between 1 dollar and 133 cents 2 cents, and so on. Sometimes, merchants go still further, and charge a full cent, when the tax involves a fraction, however small it may be. For example, in the Chicago City to cover up the 3 per cent tax, the State Street Merchants utilized the following schedule:—for 1 cent to 33 cents, 1 cent; 34 cents to 66 cents, 2 cents; 67 cents to 1 dollar, 3 cents.<sup>1</sup> This practice often leads to resentment among customers, who think that the merchants are profiteering from the tax system. As we have already seen, the common sense rule that less than a half of the smallest coin should be neglected, may work to the detriment of some dealers. For this reason, coupon books, puncture cards, and various other fractional cent tokens were utilized by dealers or their combinations in U.S.A. States.<sup>2</sup>

#### Their Efficacy

The question, naturally, arises: how far can such devices succeed in shifting the tax? It must be quite clear to those who have followed closely what has been said before that in the long run, such devices can make little difference. If the fundamental economic forces are working against the shifting of the tax, no legislative injunction or rule by trade associations can compel the shifting. All, that the most drastic measures can achieve, is to make the process a little roundabout. The dealers will reduce their basic prices by the amount of the tax to be paid. The legal requirements of the buyer paying the tax will be perfectly satisfied; but the incidence of the tax will be on the seller. However, in the short run, and where less fundamental forces are at work, these provisions will prove of great assistance. For example, customers' resentment and fear of other sellers' not adding the tax<sup>3</sup> are two powerful causes preventing shifting of the tax. Where, however,

1 Haig and Shoup p. 434.

2 For a detailed description, *Ibid.*, pp. 29-37.

3 *Ibid.*, pp. 386-387, table 28; pp. 527-528, tables 102 and 103.

State laws contain express provisions directing the shifting of the tax, the customers' resentment will be directed towards the proper objective. The fear of competition will not act as a brake to an attempt at shifting. The rules made by the merchants' associations achieve the same end, though their effectiveness is less. A merchants' association has not the dignity and the prestige of the State, and any action on its part may be misunderstood as a conspiracy against the public.

Thus, the process of the shifting of the sales tax to the consumer which is usually thought of as axiomatic is very uncertain. So many and varied are the obstacles to the shifting of a sales tax, especially in the short period, that to proceed on the assumption that it will be so passed is dangerous. While the State can be of some help at times in expediting and quickening the shifting process, it cannot do more. Therefore, in pronouncing the verdict on the justice of the sales tax, we must reckon with the possibility that it may rest on the dealers and merchants.<sup>1</sup> When it so rests, nobody can have anything to say in its favour, for it amounts to a business tax levied according to the gross income of the business. What is germane to the equity of a tax on the dealer is the ratio that the tax bears to his net income, and this will differ widely,<sup>2</sup> for gross profits differ from industry to industry and firm to firm.<sup>3</sup> Merchants

1 The shifting backwards to producers and other merchants has not been discussed here, for there is nothing more, than already implied in the preceding parts, that can be said about it.

2 The following figures are interesting in this connection:

1 per cent sales tax.

	Retail Grocer	Wholesale Grocer	Food Manufacturer
Gross Sales .. .. ..	\$ 1 million	\$ 1 million	\$ 1 million
Net Profits .. .. ..	30,000	10,000	50,000
Tax at 1 p.c. .. .. ..	10,000	10,000	10,000
Profits after tax paid .. .. ..	20,000	nh	40,000
% tax of Profits .. .. ..	33 $\frac{1}{3}$	100	20

(from Buchler, p. 200, with some modifications).

3 For varying profits in different businesses and of firms among the same businesses, see National Industrial Conference Board, *The Shifting and Effects of the Federal Corporation Income Tax*, Vol. I, pp. 183-197; also Appendices to the Report of the Committee on National Debt and Taxation, pp. 73-79.

having business, where the margin of profit is low, will be hit hard, and will have to pay an unduly high rate of tax. Businesses having a high turnover and low margin of profits will suffer. Dealers in necessities, which have, in general, a more rapid turnover than luxuries and fancy goods, will be taxed heavier. Some firms prefer to follow the conservative policy of a higher profit rate and a less turnover; others follow the adventurous course of earning high profits by selling at a low margin of gain. When the incidence is on the seller, the second type of firms will be more hit than the first and will, in consequence, be compelled to abandon their very salutary practice with a great loss to the consumers. Even otherwise in the same line of business, the net profits of various firms widely differ, running from fairly high profit rates to actual losses. To those earning lower rates, this tax would sound a deathknell.

#### IV. Adoption of the Sales Tax in Many Countries

From our previous discussions it will be seen that whatever the incidence of the sales tax, it is highly objectionable, and this fact has been widely recognized. The Colwyn Committee found it unworthy even of serious discussion, and brushed it aside summarily.<sup>1</sup> The history of the circumstances under which such taxes were passed in various countries as well as the discussions that took place in their legislatures show that even the propounders of the tax were conscious of its grave defects.<sup>2</sup> Yet, the tax has made a very rapid headway. In 1918 it formed an important element of taxation only in Germany and a few small countries; it has now spread to almost all the countries of the world except Great Britain (pre-war) and U.S.A. Federation. Introduced only as an "emergency" measure and a "distress" tax, it has so entrenched itself in the tax systems of many countries.<sup>3</sup> that it has become indispensable.

<sup>1</sup> Report, para 1031.

<sup>2</sup> See Shoup, Chap. II; Jacoby, pp. 75-77. In some of the U.S.A. States, the tax was in the first instance temporary only.

<sup>3</sup> Haig and Shoup, pp. 7-8.

The reasons for such a change in the position of the tax are not difficult to understand. Though in case of different countries different combinations of factors have led to it, the main pattern has been very similar. 1 A huge growth in expenditure, the failure of revenue to rise upto it or still worse its absolute fall, and an inability or unwillingness or both to finance the deficits from the ordinary channels of taxation reduced the governments to such narrow straits that they were willing to take advantage of any measure at hand.<sup>1</sup> It needed all the woes of the last war to spread the sales tax in Europe, where all the belligerent countries except England adopted it.<sup>2</sup> Neutral countries did not impose the tax. It required the throes of a worldwide depression to recommend itself to U.S.A. States.<sup>3</sup> Its great productivity,<sup>4</sup> the comparative ease of its administration, its indirect burden, and the needs of the governments for "more and more and still more" revenues have now made it an indispensable tax in many of the countries.<sup>5</sup> Hence, its widespread nature in spite of its being a bad tax, and being recognised as such. 1

#### V. Sales Tax in India

In India, before the adoption of Provincial Autonomy in 1937, there was no general sales tax, thanks mainly perhaps to the prevalence of the British ideas and ideals. The 1935 Government of India Act, however, while handing over to the provinces functions needing great expenses, did not give them adequate revenue sources. The popular ministries had to embark on some sort or other of nation-building activities to justify their existence, but they had not the wherewithals. Their best and most vigorous efforts at retrenchment could not save much, especially as they had

1 Seligman once rightly described a general sales tax as "the last resort of those countries which find themselves in such difficulties that they must subordinate all other principles of taxation to the one principle of adequacy" —Quoted in Green, p. 159.

2 Haig and Shoup, p. 5.

3 In U.S.A. there was no widespread sales tax movement till 1932—Jacoby, p. 71.

4 Shirras, p. 507. It has yielded in some countries about 20 percent of the total tax proceeds.

5 Jacoby, pp. 83-90; Haig and Shoup, pp. 24-25.

very restricted powers with regard to the salaries of the higher services. They searched largely for new sources of taxation, and where else could they turn their gaze except to the general sales tax? Madras, the first to launch the policy of prohibition, was also the first to have a General Sales Tax Act on its statute. Bengal passed a Sales Tax Act in 1941, and the Punjab soon followed. Bihar has a retail Sales Tax since October 1944 of 3 pies per rupee. As in the post-war period, the sales taxes are likely to occupy an important place in provincial finance, we give below the main provisions of all these acts. A critical review is given only in case of the Madras General Sales Act, but it can be easily applied *mutatis mutandis* to other acts.

#### (a) Madras Province

The Madras General Sales Tax Act, 1939, imposed a general turnover tax of  $\frac{1}{2}$  per cent on every dealer having a turnover of more than Rs. 20,000. Dealers with a turnover between Rs. 10,000 and Rs. 20,000 had to pay a flat tax of Rs. 5 a month; those with a turnover below Rs. 10,000 were exempted. Both this exemption and flat rate taxation are also found in other countries.

Except for farmers selling their own produce no other persons are exempted from the tax.<sup>1</sup> A co-operative society, even when selling its goods to its members, is liable to the tax. The Act is equally stingy in its exemption of things. Only electrical energy, motor spirit, manufactured tobacco and other goods, on which a provincial excise duty is already levied, are exempted. Since these commodities are specifically chosen for higher taxation, their exemption from this Act is necessary. No necessaries are exempted, nor are the articles subject to central excise duty free. The only items specifically exempt are bullion and specie,<sup>1</sup> cotton yarn, and hand-woven cloth when sold by dealers exclusively confining themselves to this type of cloth. In order that the tax may not hinder the home manufacturers in their competition with the producers outside the Pro-

<sup>1</sup> The exemption was removed in April 1944, but has been again given from April 1945.

vince, a rebate of half the tax is granted in respect of exports of finished articles of industrial manufacture notified by the Provincial Government. In case of hides and skins, a special concession has been given; it is taxed only at one stage.<sup>1</sup>

In 1940, after the Madras Ministry had resigned, the Governor reduced the tax to  $\frac{1}{4}$  per cent. However, he did not make a proportionate reduction in the lump tax for dealers with a turnover between Rs. 10,000 to Rs. 20,000. The fee, in their case, was only reduced to Rs. 4 a month. Any dealer, with a turnover between Rs. 10,000 to Rs. 19,200, was thus paying more than  $\frac{1}{4}$  per cent. Since October 1943, the rates have again been enhanced. The lump-sum tax was increased to Rs. 5, and the tax-rate was increased to 1 per cent. In the Finance Act for the year 1944-45, the slab rate has been raised to Rs. 8 for dealers with a turnover of between Rs. 10,000 and 15,000 and Rs. 10 for those having a turnover of more than Rs. 15,000 and less than Rs. 20,000.

**Criticism:** The Madras Sales Tax Act compares quite favourably with similar tax measures in other countries. The services are not within the scope of the Act, but this is not the fault of the Province, but of the Constitution. The rate is by no means excessive. The taxes in other countries have been heavier.<sup>2</sup> It is true that in other countries, marketing is better organized, and therefore there are less middlemen between the producer and the final consumer. A tax, therefore, at the same rate in India means a higher burden than elsewhere. Moreover, in many foreign countries it is the practice to set apart a certain percentage of the proceeds of the tax for the local bodies.<sup>3</sup> As against this, however, it must be remembered that the manufacture or production stage cannot be taxed by the provinces under the Government of India Act. This and the exemp-

<sup>1</sup> A slight element of differentiation is introduced in case of some commodities like groundnut, leaf tobacco, and cashew by providing that the "turnover" of a dealer in them shall not equal the amount for which goods are sold by him, but the amount for which they are bought. Rule 4 (2).

<sup>2</sup> Shirras, pp. 608-609.

<sup>3</sup> *Ibid*, pp. 615-616.

tion of farmers selling their own produce do much to obviate the disadvantage of our great backwardness. Taking all these factors into account, the Madras Sales Tax cannot be said to impose a heavier burden than the similar taxes in other countries. The only legitimate complaint against this Act is its failure to exempt necessaries, and the fixing of the lump sum fee for lower groups too high. The tax is expected to bring in about 486 lakhs of rupees in 1945-46.

We have seen how essential the question of the incidence of the sales tax is. When it is passed on to the consumers, there is something to be said for it; when its incidence is on the dealers, nothing can condone it. It is, therefore, essential to know where exactly the incidence of the Madras Sales Tax is likely to be. Being a proportional tax, its shifting is easy. The exemption of dealers below Rs. 10,000 will not be a grave obstacle to shifting. It will only mean that the sellers in big villages and small cities and small merchants in big cities will not be taxed. The exemption of farmers may be a slight hindrance, but farmers with a higher turnover are so few that they ought hardly to count. Moreover, the non-exemption of co-operative societies is an advancement on the tax practices of other countries, and is calculated to facilitate shifting. The lack of organizations of dealers in Madras, however, is a serious obstacle, and keen competition may prevent many retailers from adding the tax to the price. In this connection, it is sad to reflect that no steps like those on the lines of the U.S.A. States have been taken. In addition, in the Madras Province some of the dealers made no attempt to shift the tax due to a philanthropic motive. They felt that when they were asked to pay for such a good purpose as abolition of drink evil, it would be bad on their part to try to shift the tax.<sup>1</sup>

#### (b) Bengal Province

The Bengal Sales Tax Act, 1941, differs in some important respects from the Madras Act. The scope of the Act

<sup>1</sup> See Madras General Sales Tax Act, p. 71.

is the same; but the exemption limit provided is higher. For any seller importing goods into Bengal, or himself manufacturing or producing goods, the limit is Rs. 10,000; but for others, it is fixed at Rs. 50,000. The tax rate originally imposed was fairly high— $\frac{1}{4}$  anna for every rupee in the taxable turnover, i.e., 1-9/16 per cent; now it is thrice that rate. As against this it must be remembered that the tax is levied once only and that liberal exemptions of commodities are provided for. Exports are entirely exempt from tax;<sup>1</sup> necessities like essential food and fuel, agricultural capital like livestock, agricultural implements and fertilizers, fundamental means of knowledge like newspapers, text-books for primary classes and sacred books, and industrial power are not liable to this tax; articles already taxed by the Central or Provincial Government are also exempt. The 1945-46 Budget puts the estimates from this source at Rs. 2 crores.

### (c) The Punjab

The Punjab General Sales Tax Act, 1941, which aroused bitter controversy, is strangely enough milder in many respects than both the Madras and the Bengal Acts. Under this Act, all dealers having a turnover of more than Rs. 20,000 have to pay  $\frac{1}{4}$  per cent of their turnover as the tax. Merchants with a turnover of more than Rs. 5,000 and not exceeding Rs. 10,000 are taxed at  $\frac{1}{8}$  per cent; those with gross incomes between Rs. 10,000 to Rs. 20,000 are taxed at 3/16 per cent. Thus, the tax rate is as mild as the Madras rate and is more rational in case of lower incomes. Only the exemption limit is lower—Rs. 5,000 instead of Rs. 10,000. Liberal exemptions are granted under the Act. Bullion, specie (except ornaments and jewellery), food articles like wheat, wheat flour, gram, gram flour, maize,

<sup>1</sup> In the Madras Province, as we have seen, all exports are not given the benefit of a rebate of half the tax. Only exports of such manufactured products, as are mentioned by the Government, can have this. Exports of raw materials thus can never get this benefit. Dr. Naidu's defence of this, on the ground that in an ill-developed country like India, provinces are right in discouraging exports of raw materials outside their boundaries, seems queer.

maize flour, bajra and bajra flour, cotton, cotton cloth woven on handlooms and sold by persons exclusively dealing in it, agricultural implements, and means of knowledge like the holy scriptures, the periodicals and newspapers are exempted from the tax. Sales by co-operative societies, and by farmers, landlords or tenants of their farm produce are not taxed. In case of goods produced in the Punjab, the Provincial Government is empowered to remit a part or the whole of the tax. The tax is estimated to bring in only Rs. 38 lakhs in 1945-46.

**(d) Bihar**

This tax is levied on all dealers having a gross turnover of more than Rs. 5,000 at  $\frac{1}{4}$  anna per Re. of the taxable turnover. Purchases from one registered dealer by another for the purpose of re-sale are exempted, so that the tax is levied only once. The exemptions given under the Act are stingy. Only exports, sales to electricity producers and to some specific Government Departments are not taxed. The tax is expected to bring in Rs. 30 lakhs in 1945-46.

**B. Selective Commodity Duties**

Since the incidence of a general sales tax is doubtful, its effect greatly regressive, and what is worse, even unforeseen, sales duties on selected commodities are sometimes preferred. The commodities can be so chosen as to ensure the passing on of the tax, and an exemption of the poorer classes. Moreover, the effects of a tax on selected commodities can be more exactly foreseen, and therefore, attendant evils minimized. For these reasons, the duties on selected commodities have become the mainstay of government finance in many countries. Even a country like Great Britain, disinclined to indirect taxes, derived as much as about 11 per cent from Excise Duties in 1938-39.

**(a) Tax on Luxuries**

(i) **Motor Spirits:** The most suitable objects for commodity taxation are luxuries. But, as we have seen, for practical reasons, heavy taxes on them cannot be levied

frequently. The only items of luxuries, that have proved productive so far, have been petrol and other motor accessories. A great part of the tax proceeds from this source, however, is spent on the development of roads, so that this tax is to a great extent on a *quid pro quo* basis—more a fee rather than a tax. Moreover, it must be borne in mind that a tax on petrol is not only a tax on luxury but also a tax on transport, so that but for this *quid pro quo* element, the high taxation on petrol and motor accessories would be objectionable. In India the excise duty on petrol has become long since a part of the Central Excise system. For the year 1938-39, the tax on motor spirits was 10 annas a gallon; in 1945, it was 15 annas. In addition to this, various provinces have hastened to take due advantage of the greater powers of taxation given to them by the new Constitution, and levied their own taxes on motor spirits. Assam and Central Provinces have also taxed lubricants. The rate of the provincial tax has usually varied from 1 anna to 2 annas per gallon; in Central Provinces, however, the tax is levied at 5 per cent of the selling price. In 1945-46, the tax will yield Rs. 300 lakhs to the Centre and about Rs. 240 lakhs to the Provinces.

**(ii) Motor Vehicles:** In addition to this tax, motor cars have also been an object of taxation in another way. The various Motor Vehicles Acts of different provinces passed since 1923 have made this taxation, hitherto a source of local revenue, entirely a provincial subject. The local bodies have been usually compensated fully by the provincial governments for this loss on the basis of their past receipts. The fees levied under these acts are mainly for regulation purposes, but they also provide a handsome revenue, the whole of which, except in the U.P. and Bombay, is utilized for the general provincial roads. In Bombay any proceeds beyond Rs. 26.57 lakhs go to the Road Fund. In U.P. the reverse practice is followed; the sum to be credited to the Provincial Road Fund is fixed at Rs. 10 lakhs. In 1938-39 the taxation yielded Rs. 187 lakhs in British

India, out of which Rs. 86 lakhs were paid as compensation to local bodies and about Rs. 11 lakhs were transferred to the Provincial Road Fund. In 1945-46 the yield from this source is expected to be nearly the same.

(iii) **Tyres:** The 1941-42 Finance Act imposed an excise duty of 10 per cent on pneumatic tyres and tubes, which were until a few years ago imported from abroad, and paid a customs duty of 25 per cent. The tax yielded about Rs. 35 lakhs in 1941-42, and will bring in 1 crore in 1945-46.

(iv) **Motor Cars, Cycles, etc.:** Assam has gone a little further in the taxation of luxuries. A retail sales tax at 5 per cent has been levied there on motor cars, motor cycles, radios and wireless sets.

(v) **Amusements and Bettings:** Taxation of amusement has been popular in many countries. It is satisfactory to note that in India also, most of the provinces have adopted this tax. The rates vary in different provinces. The usual system of laying down taxes is the bracket system, so that the rate of the tax is not uniform for tickets of different values. The brackets are usually of the same size, and the tax rises usually of the same amount. But there is no rigid uniformity especially in the higher grade. In many provinces, to exempt the entertainment expenditure of the poor classes, an exemption limit is laid down; the exemption in Bombay Province is four annas. In some provinces, for admission fees to race courses, a heavier percentage is laid down. In addition to this, in all provinces where horse-racing is of importance, a betting tax of from 4 to 7 per cent of moneys paid as stakes is imposed. In Bengal, now, dog-racing is also taxed. This tax will bring in Rs. 350 lakhs to the Provincial Governments in 1945-46.

(vi) **Miscellaneous Taxes:** From the year 1939, the Bombay Presidency levies a tax of  $12\frac{1}{2}$  per cent on prize competitions, which are mainly a pastime of the well-to-do classes, and also partake to some extent of the character of

gambling transactions. It will yield 2 to 3 lakhs of rupees in 1945-46. In N.W.F.P., a tax of 3 pies is levied per bottle of aerated waters.

### (b) Tax on Conventional Necessaries

Next to luxuries, conventional necessities are fit for a sales tax. Unlike a tax on luxuries, where the poor are little hit, that on conventional necessities does hit them hard. But the shrinkage in consumption the tax may bring about will not produce bad effects; no direct deterioration in the health and morale of the poor will occur. The demand for a conventional necessity is, more or less, rigid, so that both from the productive and incidence point of view, a tax on it is considered to be satisfactory. Conventional necessities, therefore, have been chosen often for a heavy tax.

(i) **Tobacco:** The two conventional necessities usually selected have been liquors and tobacco, which have been good yielders of income. The rate on liquors has been especially heavy in many countries so as to minimize their consumption. In India, also, both these objects have been regarded as specially suited for heavy taxation. The taxation of tobacco, however, had till recently not made great progress, mainly due to administrative difficulties. Only six provinces, Bombay, Sind, Madras, the Punjab, N.W.F.P. and C.P. had made an attempt to tax it. Except in the case of Madras Province and Bombay City, the taxes were lump sum licence fees, varying only with the character of business, i.e., whether wholesale or retail, or sometimes its location. Rough devices were at times adopted to vary the fees according to the volume of sales. For example, in the Punjab, the licence fee varied from Rs. 2 to Rs. 10 according to the number of assistants an employer or licensee had. In C.P. the licence fee for retailers varied according to the rent of the shop. Madras Presidency had an ambitious tax measure. Tobacco was divided into two parts; (a) manufactured tobacco and

(b) unmanufactured tobacco. A wholesaler had to pay a 2 per cent tax on his total sales of manufactured tobacco. The retailer was taxed more heavily; he had to pay a tax of 3 per cent on the first Rs. 400 of the turnover, and 10 per cent on the remainder. A turnover of less than Rs. 400 was taxed under the bracket system; for gross sales not exceeding Rs. 200 a tax of Rs. 6 had to be paid, for a turnover between Rs. 201 to Rs. 400, Rs. 12 had to be given. As regards unmanufactured tobacco, no tax was levied on its sales. Licence fees were levied on wholesalers--both of manufactured and unmanufactured tobacco. The wholesalers of unmanufactured tobacco had to pay an annual licence fee of Rs. 100; in case of wholesalers having a turnover of less than Rs. 3,000 a special concession could be made by the collector. In case of manufactured tobacco, the wholesaler has to pay, in addition to the turnover tax, a licence fee of Rs. 50. A tax was also levied on manufacturers, varying from Rs. 2 to Rs. 100 according to the number of workers they employed. A broker or a commission agent was taxed at Rs. 50 a year. The widespread adoption of the lump sum taxes on tobacco in provinces meant an innate impossibility of shifting the tax, unless the licence conditions were such as to provide a sort of monopoly in a particular locality to the dealers. Where no such monopoly rights were conferred, the bigger dealers would easily bear the tax themselves, or even if they spread the tax over their turnover, the rise in price would be so little as to give an entirely inadequate compensation to the smaller dealers who would be in great trouble. Fortunately the licence fees thus fixed had been light. In 1938-39, when Madras had no tobacco tax, the various provincial taxes on tobacco yielded Rs. 25 lakhs, and in 1942-43, the yield was Rs. 56 lakhs.

The 1943-44 Budget provided for a central excise duty on tobacco. The rates of this duty were increased in 1944-45 Budget and revised in 1945. As this tax is levied at proportionate rates, it means a great advancement

on the present system of tobacco taxation.<sup>1</sup> An important lacuna in the Indian system of taxation is now filled, and a new legitimate source of revenue expected to yield about Rs. 20 crores is secured to the Indian Government.

(ii) **Restrictive Excises on Country Spirits, Foreign Liquor, Wine, Opium, etc.:** In most of the civilized countries, a tax on intoxicants is considered as doubly blessed—to the State because of its productivity, and to the individual taxed because of the restrictive effect it is likely to have on his unhealthy habit. Owing to this reason, in spite of its highly regressive character, a heavy tax on liquor is widely resorted to. This twofold purpose of the tax raises menacing questions: How far should one proceed in the restriction of the drinks? Should only the State so enforce restriction through higher taxes as to get the maximum revenue out of the drinks? Or, should it so regulate, and even if essential, prohibit them as to minimize or abolish the harm to the consumers? In fact, the problem is whether the State is to be allowed to exploit the 'evil effects of drink to maximize the revenue out of it, or whether it is to so adopt the tax policy as to really minimize the evils from drink even if it means suffering in revenue. This point seldom arises in an acute form in Western countries, for there alcoholic drinks are never looked down upon by public opinion. A drink in moderation is an almost universal habit in those countries. Any attempt at serious restriction of alcohol will, therefore, be frowned upon by the people. In India, however, the case is quite different. Both the major religions and the powerful caste customs among the higher caste Hindus are averse to it. Public sentiment in India, therefore, has always been in favour of prohibition, and the pretensions of the governments in India have been put to a crucial test. Sad to say, they have been found wanting. As long as the in-

<sup>1</sup> With the imposition of central excise duties, the provincial and tobacco duties have been entirely abolished in Bombay and Madras, and partially removed in case of C.P. The proceeds from provincial tobacco taxation are expected to be only about 4.1 lakhs in 1945-46. The Central Government, however, is compensating the Provincial Governments concerned for this loss of revenue.

crease in tax rates meant not only a decrease in consumption of drinks but also an increase in revenue,<sup>1</sup> they went on imposing higher duties, arguing that it was no use preventing licit consumption if illicit consumption were to continue, and that to prohibit the latter was very difficult. This led to a policy of fixing the tax rates in each area in light of the alternative facilities available for illicit consumption. Consumers of intoxicants had to pay a tax not only according to their consumption, but also according to the area in which they resided. People did not mind this, as long as the Governments could plead the regulatory purpose. But the depression put the Governments to a cruel trial. The higher rates could no longer bring in higher taxes; it was no longer possible to have the best of both the worlds. The regulatory purpose conflicted with the revenue desire of the governments, who immediately forgot their high aims, and vied with one another in reducing the rates and increasing the facilities for drinking.<sup>2</sup>

The introduction of Provincial Autonomy in 1937 and the acceptance of offices by the Congress later in that year once again provided a great fillip to the demand for prohibition. Picketing of liquor shops had formed an important item in the Civil Disobedience Movement of 1930. The Congress ministries, therefore, were bound to pay adequate attention to this demand. Gandhiji's article in 1939 in the *Harijan*, and his insistence on an immediate implementing of the prohibition programme at all costs did the rest. The Congress ministries vied with one another in banishing drinks from their provinces. The Bombay Ministry was the most vigorous; it provided for complete prohibition within three years, and sacrificed 150 lakhs of rupees in the first year, viz., 1939-40. Madras followed next with its loss of 65 lakhs. Other Congress provinces also sacrificed some revenues. The estimated loss due to these measures for 1939-40 compared with 1936-37 was 291 lakhs, i.e., about

<sup>1</sup> For country liquors' progress upto 1923-24, see Report of the Indian Taxation Enquiry Committee, para 212. The revenues from excises increased from Rs. 1,563 lakhs in 1921-22 to Rs. 1,853 lakhs in 1929-30.

<sup>2</sup> The number of shops in 1935-36 was 10 per cent more than in 1921-22.

20.8 per cent of the total excise revenue.<sup>1</sup> The Congress Ministries, if they had continued, would undoubtedly have carried on their plans, so that there would have been a complete extinction of, or at least a great shrinkage in this much hated source of revenue. This would have been specially welcome, as most of our excise revenue is derived from consumption of country spirits and toddy. Both these are consumed by the poor classes only. The tax on alcoholic drinks in India is, therefore, not only a regressive tax as all commodity taxes usually are, not only a flat rate tax as the salt tax almost is, but much worse. It takes larger sums from the poor than from the rich. When one remembers with this the fact that in the whole world British India was collecting the greatest percentage of central and provincial revenues from the restrictive excises,<sup>2</sup> one realizes the great step forward towards tax justice that the Congress Ministries took. The resignation of the Congress Ministries soon after the war, and the decision of the Governors soon afterwards to have *status quo* budgets stopped half way this step.<sup>3</sup> The lifting up of or relaxation in prohibition measures that followed in the wake of anti-inflationary measures, the increase in the rates of duty in some provinces, the higher bids for auctions, and greater consumption bid fair to increase the revenue from this source to Rs. 4313 lakhs in 1945-46.

We have so far assumed that the incidence of these excises is on the consumers. While this is undoubtedly so in case of all the revenues derived by the direct system, i.e., a proportional tax varying according to the value of the product—the great part of the revenue is derived that way—of the licence fees realized mostly by the auction method this cannot be said with confidence. The bidders bid for the right of monopoly, and are prepared to pay fees only to the extent of the monopoly profits they can make.

<sup>1</sup> Vakil and Patel, Finance under Provincial Autonomy, Appendix II, Table VII, p. 175.

<sup>2</sup> Patel, Provincial Finance (1921-1930), p. 280. (A thesis for Ph.D.)

<sup>3</sup> The excise revenue in 1941-42 was slightly greater than that in 1936-37—14,56 lakhs compared to 14,07 lakhs.

These profits arise from consumers' exploitation, so that in a sense the duties may be said to mean a burden to the consumers, especially so when the total quantity of supply is also fixed. The bidder's judgment, however, may not represent actual facts. He may not know or foresee the exact demand for his goods and the likely changes in it. The auction system, therefore, is much inferior from the incidence viewpoint than the direct system. Where a sliding scale system of fees under which the rate of fees increases with the amount sold is adopted, the incidence is equally doubtful.

### (c) Tax on Necessaries

In addition to taxes on luxuries and conventional necessities, it has been a practice in most of the countries to tax some necessities. E.g., England has a heavy tax on sugar. India has gone much further, and taxes a number of necessary commodities. In 1938-39, the last normal year, excise duties on necessities (including that on salt) yielded 1515 lakhs of rupees.

(i) Salt: Out of these, salt was the most important, accounting for more than 50 per cent of the total Central Excise duties. Since the consumption of salt is almost equal among the various income groups, a tax on salt is very near in effects to a poll tax. The tax has, therefore, aroused great indignation in the past. The collection of tax-free salt was the first item in the Civil Disobedience Movement of 1930. The rates of the duty have changed from time to time. For the last few years, however, the rate has been maintained at Re. 1-4-0 per Bengali maund.

(ii) Sugar: The excise tax on sugar has been the next productive item, though far below that on salt. The yield of the tax has been greatly fluctuating chiefly due to the fluctuations in sugarcane crops in India. In 1938-39, this tax yielded Rs. 424 lakhs, i.e., about 28 per cent of the central excises on necessities. The consumption of sugar is not so uniform among the various groups as that of salt. In many of the Indian villages, tea drinking is not yet

usual, though it is fast becoming so. In cities, especially big cities, the habit of taking tea has spread to the lowest classes, and some among them take more of it than the higher or middle classes. Though their expenses on ready tea appear to be smaller, that is only because their tea cups contain less milk. Moreover, the cup of tea taken by the poorer classes contains more sugar. The higher classes consume more sugar in milk and food, but this is not likely to mean much difference in sugar consumption. The variations of sugar consumption among different classes are not likely to be great, and the sugar tax, therefore, is regressive specially in the urban areas. The rate of duty on sugar was Rs. 2 per cwt. in 1938-39; in 1940, it was increased to Rs. 3.

(iii) **Matches:** The duty on matches provides another important mainstay of the excise system, bringing in about 14 per cent. The consumption of matches in cities varies with the smoking habit. In villages, however, the match-box is not generally used for lighting *bidis*. The number of matches one uses in cities depends on the number of cigarettes or *bidis* one smokes, not on his expenses on them. The poor smoke as many *bidis* as the rich smoke cigarettes, so that their expenses on matches will not be much less than those of the rich. The tax on matches also is thus highly regressive. In 1938-39 the excise duty on matches was Re. 1 per gross of boxes, when the box on an average contained less than 40 matches, Rs. 1-8-0 when a box contained between 41 and 60 matches, and Rs. 2 for a gross of match boxes containing 61-80 matches. The 1941 Finance Act doubled this duty.

(iv) **Kerosene:** For the year 1938-39, kerosene yielded a revenue of Rs. 65 lakhs, i.e., about 4 per cent. The duty was originally levied at 2 annas  $9\frac{1}{4}$  pies per gallon; in 1942 it was increased to 3 annas 9 pies per gallon. Kerosene is mostly used for lighting purposes in small cities and villages, where no electricity has been introduced. Even when electricity has been introduced, the lower classes often prefer to go on with kerosene lamps. In big cities, a substantial portion of kerosene consumption is through

stoves, which are used by all classes of population except the very lowest. Apart from the electricity consumption, the consumption of kerosene does increase with every rise in income upto a certain level. The rise is especially marked in the case of villages and smaller cities, where we come across people among the lower classes, who have no need of artificial light. The sun makes their day and night. Nonetheless, the increase in consumption stops at a comparatively early stage.

(v) **Vegetable Ghee:** The 1943-44 Budget imposed a tax of Rs. 5 per cwt. on vegetable ghee. Vegetable ghee being a product used especially in cities by the lower classes, the burden of the tax will be regressive. The tax is expected to yield 115 lakhs of rupees in 1945-46.

(vi) **Taxes on Tea, Coffee and Betelnuts:** From April 1944 a tax of 2 annas a lb. has been levied on tea, coffee and betelnuts. This further increases the large number of regressive taxes India already had. All the three commodities put together will yield Rs. 360 lakhs in 1945-46.

(vii) **Electricity:** Bombay, Madras, Bengal and Sind have levied a tax on electricity consumption. In the Bombay Province by the 1939 Act, all electricity used for the purpose of lights and fans in Bombay city is taxed at the rate of  $1\frac{1}{4}$  anna per unit for consumers using 12 or more than 12 units, and at the rate of 1 anna for those using less than 12 units; in other areas the rates are to be prescribed by notification. For theatres and cinema houses in Bombay, a special concessional rate of  $\frac{2}{3}$  anna per unit is laid down. Before this amendment in 1939, the rate for the Bombay City and other notified areas was 9 pies per unit, the consumers using less than 12 units being exempted; in other areas the rate was 6 pies per unit. It must be remembered that the increase in taxes in Bombay Province in 1939 did not amount to more than the reductions in electricity charges which the Government had secured through negotiations with Electricity Companies. In Bengal, persons consuming less than 15 units are exempted from the tax, which is levied at six pies per unit. In Sind, the tax is levied at 9 pies per unit in Karachi and other

notified areas. The Madras tax is based entirely on different lines. The tax there is levied on the licensee, and the exemption level is in terms of his turnover. If the licensee wishes to recover the duty from the consumers, he must get the previous sanction of the Provincial Government.<sup>1</sup>

A tax on electricity is a tax on an urban necessity, and as such open to all the objections we have seen earlier. In so far as the tax only counteracts that on kerosene, it is an essential counterpart of an excise duty on kerosene. But at present the tax is much heavier. Where as in case of Bombay no exemptions are prescribed, the tax is very unjust to the poor. It is good, however, that the electricity energy used for industrial purposes except in Madras where the system is entirely different is exempted, so that the tax is not one on motive power. The taxes on electricity yielded Rs. 67 lakhs in 1941-42, and are expected to bring in Rs. 95 lakhs in 1945-46.

(viii) **Madras Regulation of the Sale of Cloth Act, 1937:** In Madras, a licence fee was levied on all dealers of cloth or articles made therefrom except on those dealing exclusively in hand-woven cloth. Where the monthly turnover did not exceed Rs. 3,000, an annual fee of Rs. 2 was levied; otherwise Rs. 5 had to be paid. Being a lump sum fee, it was not likely to be shifted, but its light rate prevented it from being a grave nuisance. It yielded less than 1 lakh of rupees in 1941-42. The tax was repealed in April 1944.

#### (d) Capital Goods<sup>2</sup>

Capital goods are not usually considered as fit for excise taxation. But, consistent with its policy of replacing the loss in Customs' duties due to protective rates by internal taxes on the same commodity, the Government of India has levied from November 1934 an excise duty on

1 In all these provinces, for unmetered consumption approximately equivalent taxes are provided according to the power of the lamp.

2 The coal cess recently imposed and expected to yield 374 lakhs of rupees has not been included here, as its proceeds will be entirely utilized for the benefit of the industry.

steel ingots. The duty yielded Rs. 38 lakhs in 1938-39, and is expected to bring in 60 lakhs of rupees in 1945-46.

### C. Customs' Duties

The Customs' Duties are one of the earliest duties in history. They gained special popularity because their incidence was supposed to be on the foreigners. As a matter of fact, the foreign merchant or manufacturer seldom bears the tax. It requires, as we shall see, a combination of rare circumstances to make the foreign importer or exporter pay the tax himself.<sup>1</sup> And when the tax is not borne by the foreigner, it is, often enough, much worse than an excise duty. If its incidence is on the consumer, the price not only of the taxed part of the commodity but of the whole commodity will go up by the amount of the tax, so that it will inflict a greater burden on the consumers than the benefit it brings to the State. If the incidence falls on the home producer, the injustice of the tax will be much greater. Let us, therefore, examine the conditions for the shifting of the tax in a little detail.

#### Duties on Exports

A tax on an exported commodity will be shifted to foreign consumers, if the foreign demand for it is inelastic. This can only be so, if the supply of the taxing country forms a large part of the world supply to the importing country, and there is no possibility of alternative products. In taxing exports, there is always the danger, that though demand may seem inelastic at first sight, the presence of a high tax may give rise to an effective substitute being brought into the market. The customs' duties on exports in modern tariff systems are, therefore, seldom found to yield a large revenue.

#### Duties on Imports

What has been said about a tax on exports applies with equal force to that on imports. Until the importing country forms a very important market for the surplus pro-

<sup>1</sup> Foreigners have greater freedom, as they can buy or sell in non-taxed markets—Silverman, p. 283.

duce of the exporting country, and no alternative markets are available, the tax on an imported commodity will be shifted to home consumers. The circumstances, under which a tax on imports may be borne by the foreigners, are as rare as in the case of exports. However, the import duties play a very predominant part in the taxation systems of various countries. A tax on imports, even when its incidence is on the home consumer, is much more defensible than a tax on exports with its incidence on the home producer or manufacturer. The former is a tax on expenditure, for which something can be said. The latter is a tax on a section of the people selected at random. Moreover, many of the recent increases in customs' duties have been due to the protection policy adopted by many States. Taxes on exports are ill-suited for the purpose of protection. They can be only utilized, when the country wishing to develop particular industries is also the exporter of raw materials or intermediate goods used therein. To give the required degree of protection a tax on exports of primary or intermediate goods has to be much higher than a direct tax on the imported manufactured goods, and is likely to threaten the legitimate desire of other countries to develop their own industries for their home markets, thus leading to international resentment and retaliation. Unless, therefore, there is some special reason, the export duties are not levied for a regulatory purpose.

### Customs' Duties in India

Customs' duties in British India form a very important part of the fiscal system. They yielded in 1938-39 about one-third of the Central revenue, and about one-fifth of the total revenues, provincial and central. Export duties were levied only on a few items, and yielded less than 10 per cent of the total customs' duties. More than 97 per cent of the revenue from these export duties was derived from the duty on jute, an Indian monopoly with no easy substitute. The rest was derived from rice. The export duty on rice was very moderate—2½ annas a maund since 1930.

<sup>1</sup> Report of the Indian Fiscal Commission, paras 177-182.

The revenue from imports was more important. /The best way to get a bird's-eye-view of their justice is to divide the taxed items under four, broad divisions --necessaries, luxuries, raw materials, and means of production--and to see the proceeds from each class. This classification gives no complete idea of the exact burdens on the various income groups. There are necessities and necessities, and luxuries and luxuries. There are urban necessities and rural necessities; there are necessities where the consumption does not increase with increases in income; there are necessities whose consumption increases almost in proportion with income upto a fairly high income level. Luxuries may be defined as those commodities not consumed by the masses. Fruits and vegetables are certainly a luxury in this sense; but they are entirely different from motor cars, on which the expenditure is progressive for a very broad range of incomes. Moreover, the classification is not watertight. For example, motor spirit may be regarded either as a raw material of industry or a luxury. In such cases, the only method is to classify according to the predominant use of the commodity and this is only a compromise. Nevertheless, the broad picture given by this classification will be substantially correct.

We have already discussed the taxes on necessities and luxuries. As regards raw materials and capital goods, it must be borne in mind that the taxes on them are not easily transferred to the consumers and even when so shifted are more regressive than equally productive duties on consumers' goods. The finer the goods, the less in proportion the contribution of raw materials and machinery to their value.<sup>1</sup> The richer consumers, who generally use the finer goods, will pay a smaller rate of duty through taxes on raw materials or the capital goods. / Further where these are used for more than one commodity, even like the general sales tax, the burden of a tax on them will be seldom equitably distributed.

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<sup>1</sup> Pigou, A Study of Public Finance, pp. 142-3.

We have at hand, thanks to Messrs. Gregory and Natu, an analysis of our import duties worked out on the above-mentioned lines for the various years. We select, out of these, some typical years.

### Import Duties<sup>1</sup>

	1929-30		1932-33		1936-37		1937-38	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(in Lakhs)		(in Lakhs)		(in Lakhs)		(in Lakhs)	
1. Goods of General Consumption	10,46	46.3	12,61	28.1	12,26	32.5	12,48	28.4
2. Luxury Goods	14,16	33.7	21,67	48.3	14,09	37.2	14,11	32.1
3. Raw Materials	8.27	7.7	6.47	12.3	5.55	15.0	10,05	24.2
4. Capital Goods	5.18	12.3	5.02	11.3	5.01	15.1	6.66	15.3

This table shows that a great percentage of customs' revenue in India is derived from a tax on raw materials and means of production. About 39 per cent of the revenue is derived from this highly objectionable source of taxation and a big slice out of this is a recent addition.<sup>2</sup> The proportionate importance of duties from necessities and luxuries has declined. The duties on luxuries seem to be relatively gaining in importance compared with those on necessities. But this gain is only illusory, for the protective duties on necessities which have lessened the revenue therefrom have been largely counteracted by the new excise duties on those commodities.<sup>3</sup> It must be noted that the relatively smaller percentage of tax proceeds from luxuries is not due to smaller imports of luxury goods. In 1937-38, the value of imported luxury goods was Rs. 45,66 lakhs compared with Rs. 41,06 lakhs, the value of imported articles of general consumption. Our failure to derive larger revenues from luxury taxation is only due to our letting the luxuries off lightly. The rates levied on luxu-

1 Gregory and Natu—The Burden of the Indian Tariff, p. 16.

2 The percentage increase in revenue from this source is slightly less when we consider that in these calculations, the tax on petrol is considered as a tax on raw material, and the separation of Burma in 1937 shifted much of this revenue from being an excise into a Customs' duty. The result was a rise of 418 lakhs of rupees in Customs' duty on petrol. But, even 1936-37 figures show these two sources yielding more than 30 per cent.

3 About 6½ crores of rupees were derived from the excise duties on sugar and matches in 1938-39.

ries under the Indian Customs Tariff have been the same as those on articles of general consumption—about 30 per cent.<sup>1</sup>

There are some points in the structure of the Indian tariff which make it more regressive than would seem from an analysis like the above. For various reasons, specific duties occupy an important place in the Indian Tariff System. They contributed 31 per cent of the import duties in 1937-38. This means that in those cases unless an exhaustive classification of varieties is made, there will be a greater burden on the lower varieties of each class. Mainly due to the fear of foreign dumping, mixed duties also are assuming greater importance in the Indian Tariff Structure. In 1937-38, they contributed more than 20 per cent of the import revenue.<sup>2</sup> In both their forms, alternative and compound, these are likely to prove a greater burden on lower class consumers than mere *ad valorem* duties:

### Conclusion

In order to have the whole idea of commodity taxation—central and provincial—in a nutshell, we give here the general system of commodity taxation in 1937-38:

#### Commodity Taxation in 1937-38

(In lakhs of rupees)		
Tax on Necessaries <sup>3</sup>	42,49	56.0%
Tax on Luxuries <sup>4</sup>	15,32	20.2%
Tax on Raw Materials <sup>5</sup>	10,65	13.9%
Tax on Capital Goods <sup>6</sup>	7,03	9.3%

1 Gregory and Natu, p. 43.

2 *Ibid.*, p. 41.

3 Besides the custom's duties on necessities, this includes excise duties on sugar, kerosene, matches and salt, excises from country liquor etc., the duty on electricity, and the proceeds from tobacco duty in Bombay City. Other tobacco fees amounting to about seven lakhs have not been included as their incidence is doubtful.

4 Besides the import duties on luxuries, includes taxes on entertainments and betting. The proceeds from Motor Vehicles Acts have only been included, in so far as their benefit accrues to general provincial revenues.

5 Includes the customs' duties on raw materials, and the excise duty on petrol. From this, the sum credited to the Central Road Fund has been subtracted.

6 Includes besides customs' duties the excise duty on steel ingots.

## CHAPTER VIII

### TAXES ON TRANSACTIONS, FEES AND PRICES

#### A—Taxes on Transactions

##### I—Their Justice and Incidence

So far, we have dealt with taxes, which, however harmful their effects on production, and however uneven and unjust their burden, had some points in their favour. Their incidence, though uncertain and unpredictable at times, was usually easily ascertainable. The group of taxes we now propose to examine under the heading "Taxes on Transactions" is one, in favour of which nothing can be said except the cynical canon of plucking the goose at the place which would make it squeak the least.<sup>1</sup> Their adverse effects on production have been oft recognized, and need not detain us here.<sup>2</sup> Their injustice is no less patent. Even if we suppose some sort of uniformity in the incidence of these taxes, i.e., that ordinarily the taxes will be borne either by the seller or the buyer, they cannot satisfy in the least the dictates of justice. Often, these taxes have to be at a flat rate, either because the value of the transactions cannot be easily ascertained at the time of stamping, or because a tax according to value would mean large-scale evasion as in case of a tax on receipts.<sup>2</sup> In other cases a tax according to value is possible. But the rate cannot be progressive because of the easy possi-

1 Mill condemned these taxes as often preventing the passing of the property into the hands of those, who could make the best use of it. *Principles of Political Economy*, p. 859; also Bastable, Book IV, Chapter VIII. Hobson is more strict, and describes them as "the cumbersome relics of a past haphazard method of catchpenny improvisation."—*Taxation in the New State*, page 126. Vito D'Maro, amazingly enough, defends them as taxes on savings to counteract consumption taxes. (p. 357). If savings were to be taxed the proper way would be to levy property taxation or increase the difference between the rates of taxes on "earned" and "unearned" incomes. The method of taxing savings through transaction taxes is crude, since it hits savings in different directions and with different histories unequally.

2 The Indian Taxation Enquiry Committee, Appendices and Index, page 126.

bility of splitting up the transaction.<sup>1</sup> The tax, thus, can only be proportionate at best.<sup>1</sup> Properties of equal value do not undergo the same number of transactions.<sup>1</sup> Moreover, the rates of the tax vary with different sorts of transactions.<sup>1</sup> For any person or property, thus, the tax will vary with the forms in which the property is held, and the times he has to buy and sell these various kinds of property.<sup>2</sup>

So much on the assumption that there is some uniformity with regard to the incidence of transaction taxes. This, however, is not true. The incidence varies widely with the individual circumstances of the parties to each transaction. Moreover, in many transactions, so many complex considerations are involved, that the burden is uncertain, and distributed among a number of parties. A consideration in detail of the incidence of taxes on the main varieties of transactions will make this clear.

#### (a) Tax on Land and Property other than Stocks and Shares

The nature of this commodity, its lack of homogeneity, makes the incidence of the tax entirely a matter of individual bargain. The person, who has, or who shows, the greater need for the transaction, will have to bear the tax. As Mill pointed out, "It almost always fell on a necessitous person in the crisis of his necessities."<sup>3</sup> Perhaps, the other expenses consequent on the sale of land and other allied forms of property would throw this small item into the background, and the tax would not be felt.

With regard to the forms of property we are discussing, usually the sellers are in greater need, so that the incidence of the tax will generally lie on them. This gives rise to a grave possibility of a process akin to that of capitalization taking place. Not only will the buyer deduct from the selling price the tax he pays at the time of buying,

1 For an attempt at introducing progression in Indian taxes on transactions and its failure, see *Ibid.*, pp. 128-129.

2 In fairness we must point out that the rates are usually less on forms of property liable to change hands quickly. But this variation in rates, intended to produce a rough equity among owners of different kinds of property, may prove to be a source of great hardship in individual cases.

3 *Vide* p. 858.

but also he will discount the tax that he may have to bear in future, when he sells the property. Since the future payments are not at regular intervals, the process has none of the certainty and calculability of capitalization.<sup>1</sup> But the prospect of a series of transaction taxes is bound to have a depressing effect on prices.

#### (b) Tax on Stocks and Shares

Shares and stocks change hands very frequently, so that a tax on this form of property at the same rate as on others means a much heavier burden. There being an organized market for shares, its incidence is more likely to be uniform. The tax is often supposed to be borne by one of the three parties to the transaction, the buyer, the seller or the middleman. In that case, the tax would only be one on speculative earnings in which chance plays a predominant role. But it is not so. The buyer, the seller and the middleman are all doing useful services under the present system; and if their services are essential, their remunerations have to be paid. They will reimburse themselves for the tax they have to pay through charging a higher price for their services. The incidence is therefore much more likely to be on the users of those goods and services which the company is producing.

The case of a tax on produce exchange transactions is simpler. The dealings in the market here are in actual material goods. Owing to the reasons we have discussed above, the incidence cannot be on the purchaser, the seller or the broker. The poor grower or the consumer must, therefore, bear the tax.

#### (c) Tax on Companies' Share Capital

A proportionate tax on the authorized capital of the company at the time of its registration is hardly likely to be shifted to the consumers of the company's produce. It has to be paid once in the lifetime of the company. The new company has to compete with many other old companies which have reimbursed themselves already for the tax paid or have forgotten its existence. Moreover, in

<sup>1</sup> Seligman, *Shifting and Incidence of Taxation*, pp. 382-3.

many branches, the companies have to compete with partnerships and one-man businesses, which have not to pay this tax. Further, the advantages of incorporation are great, and the possibilities of alternative investment in other firms of business are limited. The promoters are even less likely to bear the tax, for in their initial calculations they must have taken into consideration the existence of this tax as a part of promotion costs. The tax will, therefore, be borne by the shareholders. The non-recurrent nature of the tax and its small amount prevent the tax from being an undue hardship on them.

**(d) Tax on Bonds**

Its incidence lies obviously on the borrower.

**(e) Tax on Cheques and Receipts**

Where the cheques are drawn or receipts passed in order to settle individual transactions, the tax will rest where imposed, for there is no further or continuous relationship permitting of any shifting onwards. Where, however, the instruments are commercial, drawn or passed in the course of business, different considerations apply; these taxes, then, form a part of business costs, which can, under certain conditions, be recovered from the buyers of the goods and services, in which the businesses are engaged. In such cases, all those complex considerations, which we have discussed regarding taxes on goods and services, apply. Suffice it here to observe that when the tax is *ad valorem*, the process of shifting is much easier. Where, however, the tax is a flat one, the obstacles to shifting are almost insuperable as in the case of fixed licence fees.<sup>1</sup> The greater the size of each transaction, the less the rate of the tax would be. The larger traders and businessmen have generally bigger transactions, so that these taxes differentiate in favour of them, and often force the smaller ones to bear most of, or even the whole of, the tax themselves.<sup>1</sup>

<sup>1</sup> The Colwyn Committee's discussion (p. 572 and 577) on this point is not illuminating. Silverman's remarks on this point are definitely misleading (pp. 254-5). He tells of the incidence of a business cheque as being "passed on to the consumer. There is no graduation or differentiation of the duty and as it falls on the marginal as well as on the more prosperous firms, it enters into the price-determining costs." This is to forget the great difference between a proportionate and flat tax.

It is only the very small rate of the tax and the possibilities of easily evading it, that save it from being really ruinous to small parties.

## II. Stamp Taxes in India

In spite of the grave defects of the taxes on transactions, which have earned for them opprobrium and condemnation from all economists, the ease of their collection has made them so popular, that almost all the States have adopted them as a permanent feature of their tax system.<sup>1</sup> Even a country like the United Kingdom has not only retained these taxes after the last war, but increased their rates. India has, naturally enough, not been able to keep away from the allurements of these taxes. She derived in 1940-41 no less than 5 per cent of her total revenue receipts from such taxes as against England's 2 per cent in 1938-39, so that these taxes form an important part of the Indian Tax System and deserve a close study. Unfortunately, the material is scanty. Almost all the duties on transactions are levied under the Indian Stamp Act (modified by provincial legislatures), and are lumped together under one head—Revenue from Commercial Stamps. The further sub-divisions of this heading are according to the types of stamps used (adhesive, impressive, etc.), and not according to the nature of transactions. The former has little connection with the latter, so that we have no means of knowing the relative importance of the various stamp taxes. (The Indian Taxation Enquiry Committee had stressed the need of these statistics even in the interests of sheer productivity, as the most productive rates for different kinds of transactions could only be arrived at through a process of trial and error.<sup>2</sup> From the viewpoint of justice, the necessity of these figures is even more apparent. But no steps have been taken in this matter, and the Punjab Resources and Retrenchment Committee, fifteen years later,

1 One is reminded of Smith's remark: "There is no art which one government sooner learns of another than that of draining money from the pockets of the people."

2 Report, para 317.

had to reckon with the same difficulties due to lack of data as the Indian Taxation Enquiry Committee.<sup>1</sup>

### The Scheme of the Indian Stamp Act

In the absence of these figures, because of the numerous items on which the taxes fall<sup>2</sup> we will have to confine our attention to the general scheme of the Indian Stamp Act and its analysis. The scheme of the original Stamp Act was simple. The first point to be decided in connection with the stamp duties is to determine the transactions that are fit for *ad valorem* tax, and those that are not. We have already discussed the grounds, on which this decision can be made. If the decision arrived at is that only a flat rate can be applied, the rate has to be decided arbitrarily in each case, taking precautions only to see that it does not cause great hardship, and that the law of diminishing returns does not begin to operate. Beyond these, there is no other rule in determining flat rates. With regard to *ad valorem* rates, the problem lends itself to a more scientific treatment. Here, the framers of the Indian Stamp Act fixed first the rates for three main instruments: (a) A bill of exchange payable otherwise than on demand but not more than one year after date or sight, (b) a bond, and (c) a conveyance. Since bills of exchange were the most frequent transactions, bonds less frequent, and the conveyances the least, the rates fixed for the first were the lowest, for the second slightly higher, and for the third the highest. All other instruments, on which *ad valorem* rates were thought suitable, were to be taxed at a rate levied on that one of these three, which they most resembled. Where it was felt that *ad valorem* rates on more valuable transactions would mean great hardship, a maximum duty was fixed, thus creating a class of mixed duties.

The scheme, in these broad outlines, is quite attrac-

1 Report of the Resources and Retrenchment Committee, Punjab Government, para 193.

2 We have not discussed here the taxes on entertainments, etc., which the Indian Taxation Enquiry Committee discuss in a chapter under this heading. We think that more appropriately such taxes are discussed under "Taxes on Goods and Services."

tive. It presents an advance even on the U.K. system, where more mobile forms of property are sometimes taxed at the same rate as those less mobile. For example, in Great Britain, the rate on transfer of stocks and shares is the same as that on conveyance of land. But in the execution of the scheme, and in the fixing rates on the three main instruments, many mistakes were made. These make our taxes on transactions more objectionable than those in England.

### Defects of the Scheme

(i) **Heavier ad valorem rates:** As under the Indian scheme, the fixation of all *ad valorem* rates depends on the rates fixed for the three fundamental instruments, the taxes on them are of special interest to us. The rates for these were fixed roughly at 9/100 per cent,<sup>1</sup>  $\frac{1}{2}$  per cent, and 1 per cent respectively. The rate in England was much lower in the case of a bill of exchange—1/20 per cent. In U.S.A. the rates were still lower in case of the first two—1/50 per cent in case of bills of exchange, and 1/20 per cent in case of bonds.

The heaviness of the taxes fixed in India as compared with those of England and U.S.A. was not unknown to the framers of the act. Their defence was that since the mass of transactions in India involved much smaller amounts, the imposition of rates equal to those prevalent in Great Britain would mean a much smaller revenue to the government. It was, therefore, imperative, if the Indian Government were to derive a proportionate revenue from stamp duties that the rates should be higher.<sup>2</sup> The argument has, no doubt, some show of plausibility in it. Since in poorer countries, the amount of government expenditure cannot be kept down proportionately to their low *per capita* income and the coat not always cut according to the cloth, the revenues realized from rates of taxes in force

<sup>1</sup> The rate for usance exchange bills and promissory notes for not more than one year was reduced in 1941 to 2 annas per Rs. 1,000.

<sup>2</sup> Indian Taxation Enquiry Committee, Appendices and Index, pp. 129-130.

in other countries might fall far short of the expenditure. A normal budget cannot proceed on a plan for unproductive borrowing<sup>1</sup> on a large scale. The governments of these countries must, therefore, fix higher rates in case of many taxes, and thus make up for the smallness of their national incomes, expenditure, savings and transactions. But great caution is essential in imposing these higher rates. A uniform rise in all taxes would not be correct or expedient. For example, a heavier tax on necessities and conventional necessities may react adversely on the efficiency of workmen, and make conditions much worse. The rise in case of taxes on bills of exchange, etc., which are business instruments, and whose incidence is uncertain, is equally undesirable. When this rise is preached and defended by persons, who have never pleaded for an increase in rates of taxes much more suited from the viewpoint of the justice, say income tax or death duties, it seems certainly very queer. Of all the taxes only one was preferred for this treatment, and that the least acceptable to economists!

With commercial stamps becoming an item of concurrent legislation under the Reforms of 1919, the matter worsened. The hard-pressed provinces hastened to take advantage of this new source of taxation. They applied for the sanction of the Governor-General for introducing legislation regarding enhancement of stamp duties. The Government of India reserved certain instruments for Imperial legislation and gave provincial governments a *carte blanc* with regard to others. The bill of exchange was an item, reserved for the Central Government; but the other two items were passed over to provinces, which, in most cases, increased the rates on them. The tax on bonds, in case of most provinces was raised to  $\frac{1}{2}$  per cent and that on conveyances to  $1\frac{1}{2}$  per cent.<sup>2</sup>

<sup>1</sup> It must be remembered that expenditure on many of the "nation-building departments" will be productive only in the long run, and therefore for practical purposes must be considered "unproductive."

<sup>2</sup> Report of the Resources and Retrenchment Committee, Punjab Government, Appendix F, Items 15 and 23. The tax has now been further raised in case of some provinces.

(ii) **Classification of Instruments:** In selecting the instruments for *ad valorem* rates, many errors were committed. Instruments which were suitable for *ad valorem* rates were charged at flat rates, thus depriving the governments of their much needed revenues. For example, the instrument of adoption<sup>1</sup> is admirably suitable for an *ad valorem* rate, especially as from the viewpoint of the adopted son adoption is a windfall. In spite of this, it was only taxed at a flat rate of Rs. 10. Most of the provinces have increased this rate to Rs. 20;<sup>2</sup> but none of them has introduced an *ad valorem* rate. So also, in the case of the instruments regarding formation of limited companies, a flat rate is levied. In England a duty of 1 per cent on registered capital has to be paid in addition to a tax of 10s. each on articles of association and the memorandum. In India the tax on the memorandum of a company, when there are accompanying articles of association, is Rs. 30 in the most of the provinces<sup>3</sup> (originally Rs. 15). The duty on articles of association is, in most cases, fixed at Rs. 50 (originally Rs. 25).<sup>4</sup> Only in cases of the Bombay and the Punjab Provinces, some progression is provided for. In Bombay, there are three scales for the tax on articles of association. Where the share capital does not exceed Rs. 2,500, a tax of Rs. 25 has to be paid. Where it lies between Rs. 2,501 and 1,00,000, the tax is fixed at Rs. 50. When the capital exceeds one lakh, a tax of Rs. 100 has to be paid. In case of the Punjab, where the capital does not exceed 1 lakh of rupees Rs. 25 have to be paid as a tax. In other cases, the tax is fixed at Rs. 50. The share capital of the company lends itself easily to *ad valorem* taxation. Though, due to our need of rapid industrial development, we should not impose a rate as high as U.K., there is no reason why we should not have an

1 An instrument conferring a right to adopt is in a different category. Since the right may or may not be exercised, and does not mean an immediate transfer of right to property, it is not suited for an *ad valorem* tax.

2 Report of the Resources and Retrenchment Committee, Appendix F, Item No. 3. Along with other stamp duties, this tax has now been increased in some provinces.

3 *Ibid.*, Appendix F, Item 39.

4 *Ibid.*, Appendix F, Item 10.

*ad valorem* tax with a smaller rate, say 4 annas per Rs. 100. Simultaneously, the flat rates on articles of association and the memorandum should be reduced, thus easing the burden on smaller companies. The taxes on partnership instruments, which are now in most provinces fixed at Rs. 20 (originally Rs. 10), except in the case of partnerships whose capital is less than Rs. 500, can also bear a light *ad valorem* tax. The Indian Taxation Inquiry Committee drew pointed attention to those matters;<sup>1</sup> but no heed was paid to their recommendations, though only erstwhile the government had pleaded for higher rates of transactions in India.

**(iii) Other Defects:** About the many defects of the Act like the taxing of two similar instruments at different rates, the wrong methods of valuation in some cases, etc. we need not comment here, for these subjects have been fully discussed in the note by the Legal Adviser to the Indian Taxation Enquiry Committee. There is only one more point regarding the taxation of transactions in India which deserves notice at our hands, and that is, the taxation of stocks and shares. In England, we have seen the former are taxed at the same rate as other conveyances. In India, however, the tax was much lighter. In the original Stamp Act the tax on a contract note was fixed at one anna for every Rs. 10,000 or a part thereof of the value of stock or security subject to a maximum of Rs. 10, and the transfer of the stock was taxed at  $\frac{1}{2}$  the duty on a conveyance. This was, even on the surface, a lighter duty than in England, but when the difference in the laws and practices of both countries regarding transactions in shares and stocks is considered the rates in India are seen to be imposing a still lighter burden. Whereas in England, the contract note is compulsory, in India it is not. Moreover, a contract note drawn by persons on Stock Exchanges dealing as jobbers is not liable to any duty under our Stamp Act. The practice of blank transfers, through which the document transferring the shares or stocks could pass through a large number of hands without being liable to any duty until it

<sup>1</sup> Report, paras 289, 293 and 294.

came into the hands of the ultimate purchaser, prevails widely. The Indian Taxation Enquiry Committee felt that without the co-operation of Stock Exchange authorities it was not possible to make these blank transfers a bad delivery. They, therefore, recommended that until that was forthcoming, the government should be content with making contract notes compulsory, and increasing the rate on them to 4 annas per Rs. 10,000 subject to a maximum of Rs. 40<sup>1</sup>. Since that time most of the provinces have increased rates both on contract notes and on transfers. The rate of tax on a contract note in Bombay is 2 annas per Rs. 5,000, subject to a maximum of Rs. 20;<sup>2</sup> on transfer, the rate has been revised very radically, being now 12 annas per Rs. 100. But nothing has been done to make blank delivery a bad transfer, or making compulsory the filling up of names at periodic settlements. The stamp duty on transfer of stocks, therefore, yields much less than it could do even at a lower rate, if proper rules were framed.

### Conclusion

Thus, the taxes on transactions in India, apart from the faults inherent in such taxes, suffer much even in comparison with those in force in other civilised countries. Their rates are too high. In spite of the fundamental soundness of the scheme on which these taxes are based, their execution is faulty. Sins of omission and commission are common; many items suitable for *ad valorem* taxation are being charged only at flat rates; similar instruments are being taxed at different rates, and non-essentials like possession are considered as a deciding factor in classifying the instruments. What is doubly tragic is that most of these defects were pointed out by the Indian Taxation Enquiry Committee in 1926, and still lie unremedied. |

### B. Tax Element in Fees

So far, we have been concerned only with cases, where the State, while exacting something from the individuals,

<sup>1</sup> Report, paras 305-306.

<sup>2</sup> Report of the Resources and Retrenchment Committee, Appendix F article 5(b).

promised them nothing specific in return. The charges were without a quid pro quo. Now, we pass on to consider those charges, where the "ruling principle is special payment for special service." The "fees," as these charges are called, have to be compulsory in cases, where the purpose of public regulation is paramount. In fact, usually they are so. But the element of special reckoning between the government and the payer mark out easily these fees from the taxes in theory. In practice, however, taxes and fees, thanks to the governments' all-consuming hunger for revenues, shade into each other. Out of the need for public regulations, the governments try to get some revenues in many cases, e.g., inspection of vehicles, licensing of firearms, etc. The question, therefore, naturally arises, "When do fees cease to be fees, and become taxes?"<sup>1</sup> This question is all-important to us, as we are concerned with the burden of taxation, and fees cannot be called burdens. It is apparent that as long as fees do not exceed the cost incurred by the State in the process of the service, they remain fees. But obviously, fees can go much further without passing into taxes. Being quid pro quo charges, they may exceed the cost without losing their character; only they should not exceed the value of the service rendered. The value of services rendered, however, is very difficult to determine, especially in cases where services are compulsory.

In India we have a number of "fees" which can by no stretch be called taxes; most of these are departmental fees,<sup>2</sup> which require little discussion as on the whole these departments are "spending" departments. The fees received from them are much less than the expenditures the

1 Sometimes it may even be that in what is labelled as "fees" no public purpose is predominant, and "fees" are truly speaking taxes called fees either to hide their true character or due to a genuine mistake. All such charges must be treated as taxes pure and simple, and no heading on them should prove a sufficiently powerful camouflage for students of taxation. We have already done so in treating of license fees for sale of liquor.

2 It must be remembered that if we go into sections of those departments, fees in one section may cover more than cost. But we do not wish to go into these details as it is a complicated task promising of paltry reward. As for the systems of showing these fees on the revenue side in the budget, see Bastable, p. 159.

governments incur on them. We will only be concerned here with the two most important classes of fees in India—Registration Fees and Court Fees.

### I—Registration Fees

These fees yield a considerable revenue to the Indian Exchequer. In 1938-39, they yielded no less than Rs. 187 lakhs; owing to increase in rates in some provinces, a larger number of property transactions, and increase in value, they are expected to yield Rs. 224 lakhs in 1945-46. The purpose of regulation is obvious in the registration fees. The disputes about titles to property often involve many points of fact, which, in the absence of a registration system, are very hard to decide, and in any case involve waste of time and money. The Indian Registration Act makes registration compulsory in almost all cases of immovable property worth more than Rs. 100; unregistered documents have no probative value in this case. In other cases, registration is voluntary, but confers on the party protection against all prior transactions of which it has no notice.<sup>1</sup> The fees are charged on a regressive scale, combining the principles of the cost of service theory (the cost will vary not with the value of the documents but with their length and intricacy) and of the benefit theory. The rates vary widely with different types of instruments, but on the whole they are reasonable, and cannot be said to exceed the value of the services rendered.<sup>2</sup>

### II—Court Fees

The court fees have been for a very long time a subject of much controversy between two parties. One has held that a resort to court of law is due to the carelessness and neglect of the parties concerned, and therefore not to charge them any fees is to burden the general public for the fault of some individuals; the other has contended that

<sup>1</sup> Indian Registration Act, 1909, Secs. 17, 18, 48 and 49.

<sup>2</sup> In 1923, the fees paid in respect of compulsory registration were less than 1 per cent of the value of the property affected in every province, the highest percentage being 0.8 percent in Bihar and Orissa, and the lowest being 0.2 per cent in Bombay. (Indian Taxation Enquiry Committee Report, para 327). In spite of the recent rises in rates, the percentage cannot have much risen.

the resort is mainly due to the imperfections of the law and the law-giver, and to impose a court fee is, therefore, punishing the individuals for no fault of theirs.<sup>1</sup> We shall not go into the merits of this controversy. We shall only point out two salient facts in the Indian Court Fees. We have to-day no actual record showing the amount of fees levied in the course of litigation, and of the actual costs of the courts. The figures available are "misleading and erroneous," so that unless a record on the lines suggested by the Civil Justice Committee of 1924 is made, we have absolutely no data on the all-important question of how far the court fees exceed the cost element, and may, therefore, contain an element of taxation. Even if after a careful examination of the records in future, we come to the conclusion that the fees did exceed the cost, this would not put them in the category of taxes. Most of the court fees are derived from the administration of Civil Justice, and in Civil Justice it is usually the losing party which has to bear the whole cost. Most of the fees may, thus, be viewed as a sort of penalty on the losing party for unnecessarily troubling the State.

### C. Tax Element in Prices

From the administration of commercial departments, the Government of India derives considerable "industrial revenue"; and therefore the question of tax element in the prices charged for these services is very important. Unfortunately, this is very difficult to decide. That prices charged by State departments may contain a tax element is undeniable; for otherwise all that the State has to do to take the tax burden off its subjects is to nationalize the services, and so charge the prices as to derive the necessary revenues from them. To regard a State charge of 1 anna on goods worth Re. 1 as a tax, and to plead that there would be no tax at all if the State took over the company and charged Re. 1-1 as the price, the 1 anna going to the general revenue fund, is absurd. It would easily be recognized even as in the case of fees that there is no tax until

<sup>1</sup> For this controversy, see *Ibid.*, Appendix XI, pp. 159-160.

the price charged exceeds the cost. But can we say that every pie of profit is a tax? The technique of commercial accounting is only recent and yet not perfectly developed. Besides, the factor of risk-taking cannot be adequately taken into account by any system of accounting. Even if these difficulties were got over, the problem of deciding the tax element in prices would not be easy. Most of the businesses, which the State undertakes, would have otherwise lent themselves to private monopolies. Under them, more than normal profits might well have been made in spite of State control. Can it be contended seriously that the rates charged by the State, even when less than those, which would have prevailed in absence of nationalization, contain a tax element, just because the State makes a profit out of them? The real criterion is the prices that would have been charged in absence of State ownership; but these cannot be usually determined except in cases, where the government is operating just to set up an ideal either by way of prices as in recent cheap grain stores or to ensure purity, in which cases there is seldom any dispute about the tax element for the costs usually exceed the incomings. The majority of economists have, therefore, been forced to accept an unsatisfactory compromise, that if the State only realized a fair rate of return on capital, there is no tax; if the State earns more, the prices contain a tax element.

We have said above that there is no question of a tax, as long as the incoming of a commercial department do not exceed its outgoings. This is, no doubt, true in a broad sense. But there are cases, when the commercial department renders various types of services. It may be that while on the whole the department makes no profits, in the allocation of some rates regard may have been paid to considerations other than commercial ones like the ability principle, the effect on national economy, etc.<sup>1</sup> In

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<sup>1</sup> In determining railway rates, regard is often paid to the desirability of developing particular industries, or of not hitting a certain section of the people. The Telegraphs section of the Posts and Telegraphs Department of India was run at a loss till recently because of the concession given to press telegrams.

such cases, strictly speaking, the consumers of one sort of services are taxed, of the other sort subsidized. From the one the State extorts a tax, on the other it confers a benefit. However, due to the scarcity of material available and the difficulty of assigning costs between various sections of a department, it is not possible to take this into account. We must, therefore, be content with the accounts of the department as a whole.

### (i) Railways

Railways are the most important of the commercial services run by the Government of India. When in 1924, railway finance was separated from general finance, a convention was agreed upon, whereby the railways were to contribute every year to the general revenues 1 per cent of the capital at charge of commercial lines plus 1/5th of any surplus profits remaining after this payment. The loss on the working of the strategic lines was to be borne by general revenues. Any surplus remaining after this payment to general revenue was to be transferred to the Railway Reserve Fund, but if the amount available for the transfer exceeded in any year 3 crores, 1/3rd of the excess was to go to general revenues. Thus, general revenues were to derive a benefit from State ownership of railways in three ways:—

(a) Every year the general revenues were to receive 1 per cent of the State capital invested in commercial lines. This was a fixed charge irrespective of the state of railway finances. Obviously, this meant the policy of so fixing rates as at least to derive this much additional profit.

(b) If a surplus was left after this charge, 1/5th of it was to go to general revenues. This provision might have been inspired by the legitimate desire to share the extraordinary profits consequent on monopoly. But the monopoly here, it must be remembered, is a State monopoly, and there is always the danger that with a view to benefit general revenues, railway rates might purposely be so fixed as to bring in extraordinary profits. In such a case, this clause will be no less objectionable than the first, with this impor-

tant difference that the intentions even of the Government of India might not materialize and thus there may be no payment under this clause.

(c) Any surplus after paying the first two charges is to go to the Railway Reserve Fund. But if this is greater than three crores, only 2/3rd of the excess goes to the fund, the rest going to the general revenues. This clause is subject to the same objections as (b).

From 1924-25 to 1930-31 there was no difficulty in meeting the fixed charge (a), and in some years even (b) and (c) clauses brought in handsome sums. During those years, the huge sum of Rs. 41.7 crores went in to the general revenues. But even in this period, the last two years were by no means happy ones. The small surplus realized in 1929-30 was not enough to meet the fixed contributions; in 1930-31, there was no surplus at all. The dues were paid out of the Railway Reserve Fund. From 1931-32, the losses began to be huge, and the Railway Reserve Fund having been wiped out, there was no source from which to pay the fixed charge. This state continued upto 1936-37. After 1937-38, the situation began to improve and small surpluses began to be realized. By the year 1938-39, the railways had incurred a liability of 36½ crores to general revenues. The world war that commenced in September 1939 brought about a great increase in traffic, and a contraction of other transport systems to an embarrassing extent. The increase in railway traffic, that followed as a consequence, along with the increases in rates, improved unexpectedly the position of railway finances. By 1942-43, the railways paid back all past loans to general revenues, besides paying their fixed annual contributions. Since all past arrears were wiped out, a continuance of the convention would have meant under the war conditions an excessive accumulation in the Railway Reserve Fund and a comparatively meagre contribution to General Revenues. It was decided in 1943 that the allocation of railway surpluses should no longer be made on the basis of the old convention, but it should be decided each year according to the

relative needs of the general revenues and the railways! For the year 1943-44 the relative importance of these needs was estimated at 3:1. The arrangements were again revised and for the years 1944-45 and 1945-46 the railways' contribution was stabilized at Rs. 32 crores.

The grave burden put on railway services in this way resembled closely a tax. But as to the exact classes among whom the tax should be allotted nothing certain can be said. In fixing railway rates, necessities are charged specially low, so that the consumers of those commodities pay no tax.<sup>1</sup> Even within goods which are not necessities, a preference may have been given in national interests to certain types of goods. Among the passengers also, only certain classes may be actually taxed, and the incidence of the tax will be different according as their travelling is for business purposes or for personal reasons only. In the former case there is a possibility that the tax may be shifted as a part of the business costs to the consumers of those goods and services.

#### (ii). Posts and Telegraphs

Like the railways, the posts and telegraphs offices conduct a variety of services<sup>2</sup> but most of them are singularly unsuitable for taxation.<sup>3</sup> The services either like the post-card are such as are vastly used by the poor only, or they are services mostly required in course of business. It was, therefore, that the Government of India when commercializing the accounts of the Posts and Telegraphs Department decided that it should not be burdened with any payments to the general revenue. The Government had to pay interest on any balances of the Department left with them, and vice versa. In 1940, however, rates were raised due to the war, and this being a distinct measure of taxation, the extra revenues on this account were credited to the general revenues. In the later budgets there were further increases in rates whose benefits also went to the

<sup>1</sup> When the railway rates were increased in 1940, foodgrains were exempt.

<sup>2</sup> See Lutz, p. 242.

<sup>3</sup> Bastable is opposed to this view. See p. 575.

treasury. Fortunately enough, from this rise in rates the post-card mostly used by the poor has been exempted. This rise in rates, so far as it pertained to business communications, was just, for in the seller's market that ensued in wartime business costs were no consideration in fixing prices, and the incidence of the tax fell only on businessmen, who were deriving greater incomes due to the war. Among them, of course, the tax was by no means equitable, for the expenditure on telegrams and business communications depends not on the net incomes of the businessmen, but on their gross incomes and the nature of their business. But for the general public there was no cause to complain except in so far as the services were directly used by them.

### (iii) Profits from Coinage, etc.

These profits are incidental only, and cannot be classed as revenue.<sup>1</sup> In 1945-46, these are expected to amount to Rs. 12 crores mainly due to the contribution of Rs. 10 crores from the Reserve Bank owing to the large earnings it makes on its sterling securities and owing to the shareholders' dividend being limited to 4% only. But in 1938-39, they amounted to 0.6 crores only.

### (iv) Irrigation

Irrigation differs in many ways from the departments we have so far discussed. Its direct benefits are confined to a few; it helps the producer to increase his produce and his earnings. We do not, therefore, see anything wrong in charging the farmer a substantial part of his extra earnings due to irrigation. There is no reason why the State should only charge the farmers a price just enough to cover the cost and thus make an underserved gift to him at public expenses. Care, of course, should be taken to see that farmers are in no case charged more than a certain part

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<sup>1</sup> The deliberate resort to the Printing Press mainly to finance foreign purchases in India, that has characterized the Government's War policy, is not discussed here.

of the extra produce due to irrigation. As it is, India is losing on the whole on her irrigation and navigation works.<sup>1</sup>

#### (v) Forests

Due to the fact that any investment in them brings a return in the long run only, and even more due to the need of properly preserving and protecting them in national interests, forests are regarded specially suitable objects for State enterprise. In accordance with these well-recognized principles, the Governments in India manage many of the forests and derive some incidental profits from their ownership.<sup>2</sup> The prices of Government forest products compare quite favourably with similar products produced by private enterprise. Profits from these cannot, therefore, be regarded as taxes.

#### (vi) Electricity Schemes

These mean a net loss<sup>3</sup> to the Governments. There can, therefore, be no question of a tax element in them.

Thus, with the exception of railways in India and the Posts and Telegraphs Department after the war, there is no tax element in the prices charged by the Government of India and the Provincial Governments.

1. The following table shows the profitability of Irrigation and Navigation to different Governments during 1938-39.

Government	Rate % on Capital Outlay (excluding interest charges)			Total
	Irrigation	Navigation		
Central	..	..	-3.84	..
Madras	..	..	+0.68	-5.04
Bombay	..	..	-2.54	..
Bengal	..	..	-2.94	4.50
U. P. ..	..	..	+2.28	..
Punjab	..	..	+8.39	..
Bihar	..	..	+1.46	..
C. P. & Berar	..	..	-3.59	..
N.-W. F. P.	..	..	+3.92	..
Orissa	..	..	-3.30	-3.32
Sind	..	..	-1.88	..

2 The Governments in India derived a net revenue of 67 lakhs of rupees from forests during 1938-39.

3 In 1938-39, on the whole, a loss of Rs. 0.6 lakhs was made.

## PART III

# THE BURDENS OF TAXATION ON INCOME GROUPS

## CHAPTER IX

### CALCULATIONS OF TAX BURDEN IN GREAT BRITAIN AND U.S.A.

#### I.—British Studies

The importance of the question, "How much of his income does an average person belonging to a particular income group pay to the Government by way of taxation?" was realized in England long ago. As early as 1756, an attempt was made to answer this question.<sup>1</sup> Since then, the subject has continued to exercise the attention of English economists.<sup>2</sup> It was not till 1919, however, that its study was put on a scientific basis. In that year, with a view to furnish the facts, on the basis of which alone the very difficult problem of post-war Government finances could be tackled, Sir Herbert Samuel tried to assess the burden of taxation on different income groups in the year 1918-19.<sup>3</sup> To show the changes brought about by the war, he took for comparison the last pre-war year, 1913-14. In order that the whole problem might be viewed in a better perspective, he went back another decade, and selected the year 1903-4. Sir Samuel did his work so well, that this problem won official recognition in 1927.<sup>4</sup> At the same time that the Colwyn Committee was working on this problem, Mr. David Jones was trying to bring upto date the calculations of Sir H. Samuel,<sup>5</sup> Though the

1 "Calculations of Taxes for A Family of each Rank, Degree or Class for one Year"—Joseph Massie.

2 Six such attempts between 1833 and 1913 are enumerated, and the summary of their results given in Jones—*The Nature and First Principles of Taxation*, pp. 273-284.

3 Taxation of the various Classes of People, *Journal of the Royal Statistical Society*, March 1919, pp. 143-182.

4 Report of the Committee on National Debt and Taxation, paras 218-255, and Appendix X in Appendices, pp. 48-64.

5 Pre-War and Post-War Taxation—*The Journal of the Royal Statistical Society*, 1927, pp. 685-718.

publication of the Committee's Report took much of the ground off his feet, the difference in his method of approach was of importance. In 1930, because of the great changes in tax structure that took place after 1926, Mr. Sandral tried his hand at this problem.<sup>1</sup> In 1934, an attempt was made on behalf of the Swedish Government to work out the burden of taxation on various classes of the people in England.<sup>2</sup> The latest effort in this direction was made in 1942, when at the request of the National Institute of Economic and Social Research and under its auspices, Messrs Shirras and Rostas made an estimate of the burden of British taxation in 1937-38 and 1941-42.<sup>3</sup>

Due to the simplicity of the prevalent tax system, and because of the thoroughness with which the problem was handled, Sir Herbert's address and the Colwyn Committee Report remain the classics of the available literature on the measurement of tax burdens. The other studies follow their method in the main, with a change here and there usually to suit varying conditions. We shall, therefore, deal at length only with the first two, concerning ourselves with later attempts only in so far as they introduce novel conceptions or lay down new methods to cope with new problems. As both in general method and in detail the Colwyn Committee followed faithfully Sir Samuel and in most of the cases adopted or only slightly modified his figures,<sup>4</sup> we shall take the two together.

#### Tax Structure in U. K.

Before passing on to a detailed examination, it is, essential to bear in mind the chief sources of revenue in U.K. in the selected years:—

1 The Taxation of Various Classes of the People, in the Journal of the Royal Statistical Society, 1931, pp. 83-94.

2 Referred to in Ursula Hicks "The Finance of British Government, 1920-36," p. 272.

3 The Burden of British Taxation.

4 Report of the Committee on National Debt and Taxation, para 221.

## Total Net Receipt.

1918-14 1918-19 1923-24<sup>1</sup> 1925-26<sup>1</sup>  
(in thousands of £s.)

(a) Income Tax	..	..	43,902	257,708	271,433	258,065
(b) Super Tax	..	..	3,839	35,560	..	69,883
(c) Death Duties:						
Estate Duty	..	..	21,649	25,144	49,805	52,861
Legacy and Succession duties, etc.			5,517	5,655	7,752	8,469
(d) Stamp Duties	..	..	9,083	12,417	21,599	25,129
(e) Inhabited House Duty	..	..	1,994	1,850	1,900	28
(f) Land Tax	..	..	690	643	618	678
(g) Excess Profits Duty	..	..	..	283,977	-1,867	2,883
(h) Corporation Profits Tax	..	..	..	..	28,451	11,705
(i) Land Value Duties	..	..	785	710	299	262
			87,809	623,674	436,717	427,408
Tea	..	..	6,499	16,054	10,731	5,780
Sugar, etc.	..	..	3,728	28,098	38,117	19,371
Other Foods	..	..	1,078	3,540	2,680	1,549
Tobacco	..	..	18,284	46,202	51,882	53,497
Spirits	..	..	23,976	24,242	54,087	49,928
Beer	..	..	13,655	25,424	81,702	82,403
Wine	..	..	1,152	1,400	3,369	3,746
Entertainments	..	..	..	7,520	9,285	5,714
All other duties	..	..	7,255	10,544	13,678	15,716
Customs and Excise Duties	..	..	75,227	163,129	265,481	237,704

## A—Sir H. Samuel and the Colwyn Committee

The way, in which both the studies calculated the burden of these taxes, is very instructive, and will bear a patient study.<sup>2</sup>

## Inland Revenue Duties

(a) and (b) Income Tax and Super Tax: The problem of relating these to a person's income is simple, for if we rule out evasion, by their very definition and nature, their amount is determined by the income of the taxpayer.<sup>3</sup> Nevertheless, even here, the complications to which our

<sup>1</sup> The Committee on National Debt and Taxation selected these two years in addition to those chosen by Sir Herbert.

<sup>2</sup> Both these studies assumed that the tax burden was borne as intended, i.e. that direct taxes were borne by the payer, and indirect taxes shifted to the consumers.

<sup>3</sup> This is only true of the general income tax levied in English-speaking countries. On the continent, however, where the income tax consists of a series of partial income taxes levied on different kinds of income at different rates, the sources of income of an income group will have to be taken into account.

growing concept of justice has led us, gave rise to some difficulties. For example, in U.K. in 1903-04, the tax was levied at a uniform rate of 11d. per £ on all incomes, the only modification being in relation to the abatements at the lowest points in the scale. By 1925-26,<sup>1</sup> so many complexities had been introduced in the income-tax laws, that for a very long range of incomes circumstances having nothing to do with income became the deciding factor in determining the amount of the tax. Whether a person was in the blessed matrimonial stage, the number of children and dependent relatives he had, whether his wife was earning, whether and how much of his income he was making by personal exertions, and the life insurance premia that he paid—all these went to determine the income tax he had to pay, and in the lower ranges of income they had a greater influence than income itself. When calculating income tax burden on the various income groups, both the studies ignored all minor modifications like life insurance premia, the earnings of the wife, the double income tax relief provisions, and the number of dependent relatives. They got over the difficulty of marriage and children allowances by assuming that every person was married and had three children under 16. For purposes of comparison, however, they gave one side table each, to show how bachelors belonging to different income groups would be taxed. The other major factor, viz., earned income allowance could not be so easily disposed of. Therefore, in the table showing the final results, two alternative cases were taken. Sir Herbert took the cases as (i) where income was wholly earned,

1. The tax that a person had to pay in 1925-26 was calculated in the following way:—Assessable Income = Actual Income—Earned Income Allowance (1/6th of the Earned Income, not exceeding £250). From this, to arrive at taxable income, various deductions had to be made—a personal allowance of £225 for married persons and of £135 for others; a further allowance upto £45 where the wife had earned income, an allowance of £60 for widower's or widow's housekeeper or for a widowed mother of an unmarried person taking care of children, an allowance of £36 for the first child, provided the child was under 16, or continuing full-time education, an allowance of £25 for each subsequent child on the same basis, an allowance of £25 for each dependent relative incapacitated by old age or infirmity etc. On the first £225 of taxable income, the standard rate was to be charged, and on the remainder the full standard rate. From the sum so arrived at, deductions at the allowable rate had to be made on life insurance premia.

and (ii) when it was entirely unearned; remarking that persons having partly earned and partly unearned incomes would have to pay an income tax lying somewhere between these two. The Colwyn Committee thought the second case rather unusual, and therefore took in its stead the instance of a person, having half earned and half unearned income.

The super tax, first introduced in 1909-10, had no complications about it. Its rate was directly related to the income of the taxpayer, so that given the income of a taxpayer, the tax he had to pay could at once be calculated.

(c) **Death Duties:**—Even on the most favourable assumption about their incidence, viz., that they are borne by the deceased, and in their most favourable form, i.e., when the amount to be paid varies only according to the estate left by the deceased, the task of relating these to the taxpayer's income is a difficult job. The tax is a capital tax levied at death; as a deferred tax on income, it varies according to the age of the estate, the history of its acquisition, the proportion of the earned to the unearned income of the deceased, the time of death, etc.<sup>1</sup> Nonetheless the conception of relating every tax to income having gained ground, a technique of measuring death duties was devised quite early. In a paper put before the Select Committee of the House of Commons in 1906, a method of treating their burden as equivalent to the annual life assurance premium, which the individual would be charged if he took out a life policy to assure the capital sum required to pay his estate duty, was laid down. Both our studies followed this procedure, but the Colwyn Committee were more careful to point out its limitations. The method assumed that the estate excluding the policy would remain the same at the time of the taxpayer's death as at the time of his taking out a policy; the figures of the Estate Duty revealed that the estates usually increased after middle age. Another facile assumption was that the rates of the Death Duty would not change between the time when the policy was taken out and the taxpayer's death; the rates of the duty had changed thrice between 1909 and 1926. The Colwyn Committee calculated

<sup>1</sup> These have been discussed at length in Chapter IV.

the life insurance premium on the basis that a person took out his policy at 45, Sir Herbert Samuel proceeded on the assumption that he did so at 40. The Colwyn Committee, though working out two tables, according to whether the income was wholly unearned, or half earned and half unearned, incorporated only the results of the second case in their final table; Sir Samuel took only the first case. The investments were assumed by both to yield a 5 per cent interest.

While the burden imposed by the most important part of death duties could be thus calculated, the Legacy and Succession Duties, whose rates varied from 1 per cent to 10 per cent according to the degree of relationship that the successor bore to the deceased, could not be convincingly dealt with. According to the Colwyn Committee, the incidence of these duties was intended to be, and was usually in fact, on the inheritor.<sup>1</sup> In any case, as the amount of the duties bore no direct relation to the estate of the deceased, their allocation was very difficult. At the same time, it was felt that the omission of these duties would be unfair to the propertied classes. A very rough procedure was, therefore, adopted. Each deceased was regarded as contributing to these duties in the same proportion as to the Estate Duty.

(d) **Stamp Duties:** The Stamp duties, though paid mainly by the middle and higher classes, are, as we have seen, contributed to very unevenly by persons within these classes. To strike an average was therefore thought misleading, and they were omitted in both the studies.

(e) **Inhabited House Duty:** The connection between a person's income and his establishment expenditure, though varying widely with the individual factor, is sufficiently close to permit representative figures. These figures were furnished to Sir Herbert by Dr. Stamp, who had made a very close study of this matter. By the Finance Act, 1924, the duty was abolished.

(f)—(i) **Land Taxation etc.:** These duties were not taken into consideration by both the studies for obvious

<sup>1</sup> Report of the Committee on National Debt and Taxation, para 461.

reasons. The Land Tax has been redeemed in many cases, and is, therefore, a decreasing source of revenue. Moreover, most of it had been capitalized, so that by the beginning of the 20th century it had practically ceased to be a tax. The Excess Profits Duty, though a great revenue-producer while it lasted, was an avowedly temporary war measure, its allocation among income groups being impossible. Taking these factors into consideration, Sir Herbert omitted this. The duty was abolished in 1921, so that the Colwyn Committee had not to worry about it. The Corporation Profits Tax, levied in 1920 at 5 per cent on all corporation profits, was reduced to  $2\frac{1}{2}$  per cent in 1923, and abolished in 1924. It thus existed only in one out of the five selected years. As the income a person derives from corporations varies widely within the same income-group, the tax could not be brought into any definite relation with the individual's income, and had to be let alone. The Land Values Duties levied under the Finance Act, 1910, were an attempt to tax future unearned increments, and were abolished in 1920.<sup>1</sup> By their very nature, they did not admit of any relation to income.

In addition to all these items left out, there is one more item omitted, which is not acknowledged, viz., the tax on reserves of companies, public and private, amounting to about £54.8 million in 1922-23.<sup>2</sup> This is considered as a part of the income tax and not shown separately. Since income from shares does not bear any definite proportion to the total income of individuals belonging to the same income-group, and since the proportion of reserves to distributed profits varies widely from one company to another, this item had to be omitted.

#### Customs and Excise Duties

Unlike the Death Duties there is no logical difficulty in expressing these taxes as a percentage of income, since they lay a regular burden on the taxpayers. The burden, however, depends on their consumption of dutiable goods, and

<sup>1</sup> *Vide Chapter VI.*

<sup>2</sup> Report of the Committee on National Debt and Taxation, para 306.

to a large extent varies independently of the size of income.

**Family Consumption:** The first problem in this case is to find out the amount of each dutiable article consumed by the representative persons of the various income-groups. The best way of obtaining this is from a collection or collections of household budgets. But often the required information is not available in these budgets. Various surmises and deductions have, then, to be made. With regard to tea and sugar, both Sir Herbert and the Colwyn Committee found the budget data satisfactory. But in the case of tobacco, alcohol and many other small items, they found that the available budgets did not help them much, and they had to fall back on less satisfactory substitutes.

**Budget Studies:** At the time Sir Samuel wrote, three main inquiries into family income and expenditure had been made in U. K.:

(i) The Board of Trade had collected 1944 working class budgets in 1904 from towns distributed throughout the U.K. One of the years that Sir Samuel selected coincided with this period. A great time had lapsed between this year and his other selected years, and a still greater time between 1904 and the Colwyn Committee's two additional choices. But as no equally comprehensive enquiry into family budgets had been undertaken after 1904, and as the working classes are markedly conservative in their habits, these budgets were mainly used in all calculations by both the studies.

(ii) In 1908, the Board of Inland Revenue, then also responsible for Excise, collected particulars relating to the consumption of dutiable articles with regard to 225 working class families in rural districts. These formed a valuable corrective to the Board of Trade budgets, which had been collected from towns only. At the lower income groups of £50 and £100, they were assigned an equal status with the 1904 budgets. For the income-group of £150, since this inquiry included only a few families (12), they had to be relegated to the background.

(iii) The Treasury Committee on the Costs of Living of the Working Classes collected in 1918 statistics relating

to 1306 families. The figures furnished by them were related not to income, but to broad divisions of occupations, viz., unskilled workers, semi-skilled workers, skilled workers and clerks. However, Sir Herbert was informed that the category of the skilled workers corresponded to an income of £200 and that of the unskilled to £150 income-group, and in ascertaining the consumption of two main taxable commodities, viz., tea and sugar for 1918-19, Sir Samuel relied chiefly on these figures. In the last months of 1918-19 after his address had been delivered, there was a large increase in the consumption of these two commodities. The Colwyn Committee did not, therefore, accept these estimates, and worked forward from 1904 budgets.

In addition to these three sources of information the Colwyn Committee were supplied with 600-700 household expenditure budgets collected in 1921 from families with incomes ranging between £300-£1500. These, it seems, were not used by the Committee.

**Difficulties in Calculating Tea and Sugar Consumption:** Armed with these data, Sir Herbert and the Committee forged their way ahead, but the path was not smooth. The classification followed in the Board of Trade Budgets regarding income-groups was not the same as they wanted; the number of persons per family in the various groups was different. The results of the budgets, therefore, had to be modified. The figures of consumption of the wage group nearest to the required income-group were taken, and an approximate allowance for the change in income and in the size of the family which was uniformly fixed at 5—two adults and three children—was made. The highest income-group that the Board of Trade Budgets covered was £150; but in Sir Herbert's opinion the maximum consumption of tea or sugar was reached at £200.<sup>1</sup> To arrive at the tea consumption of an average person of this group, he deducted from the total tea consumption

<sup>1</sup> The Colwyn Committee, however, thought that the highest tea consumption was reached at £150—Appendices, p. 49.

the consumption by persons below £150, and divided the result by the number of persons earning more than £150. For the sugar consumption of the income-group £200, he relied on an estimate of the Board of Customs and Excises.<sup>1</sup> One minor difficulty still remained; the figures of sugar consumption obtained from household budgets denoted only sugar used in home preparations. They did not include sugar consumed in syrup, jam, marmalade, etc. It was revealed by the 1904 budgets that the expenditure of various income-groups on these items bore a nearly constant ratio to their expenditure on sugar. The amount of additional sugar consumed in syrup, etc., was thought to be in about the same proportion as expenditure on these items. From these two facts, a method of finding out the sugar consumption of the representative families of various income-groups by way of these market preparations was evolved. The national household sugar consumption arrived at from the family budgets was deducted from the recorded sugar consumption of the whole nation; the result gave the total sugar consumption through market sugar preparations. The percentage of this to the total home sugar consumption was calculated, and a proportionate addition was made to the home sugar consumption of the standard family of each income-group.

**Consumption in Different Years:** Having obtained the consumption of various income-groups ordinarily for 1904, they had to consider some method to find out family consumption in the other years they had selected. Fortunately, they had the figures of total national consumption of these commodities in various years. Their only problem was the assignment of these among the various income-groups. For this, they took into consideration (a) changes in real wages effected in the intervening period, and (b) changes in the retail price of the taxed article. If these two had not substantially changed, the percentage change in the consumption of each income-group was taken to be

<sup>1</sup> The method adopted in getting tea consumption of the income group of £200 and above could not be applied here, because the budgets could not furnish total sugar consumption of the working class.

equal to that in the total national consumption. Where they had changed considerably as in the years after the war, recourse had to be taken to reasonable surmises. For post-war years, due to a great rise in money wages, the £50 income-group was dropped; and the income-group, where maximum tea and sugar consumption was reached, was taken to be £500 and above.<sup>1</sup>

**Duties paid on Tea and Sugar:** The consumption of tea and sugar of standard families belonging to various income-groups in the selected years having thus been worked out, the next step of calculating the duty paid by them was easy. Throughout the period Sir Herbert took, the duty on both these commodities was a uniform specific duty levied per lb. The question of measuring the burden, that these taxes placed on each income-group, reduced itself to a working out of the rule of three. The Colwyn Committee, however, were faced with a more difficult task. By 1923-24, Imperial Preference had been introduced, and rebates were given on Empire tea and sugar. Three alternatives were open to the Colwyn Committee:—(i) to assume that the higher rates of duty were shifted to the foreign exporters, and calculate the tax burden as if the entire commodity was taxed at the lower rate only; (ii) to assume that the price of the taxed commodity was raised by the higher tax rate, and to treat the whole price rise as incidence; and (iii) while recognizing that the price of the commodity was likely to increase by the full rate of the higher tax, to hold steadfast to the meaning of "incidence" as we have defined in Chapter II, and exclude that part of the price rise which would go to the Empire producers. This could be done by taking the entire tax proceeds from the commodity, finding out what percentage it formed of the total money value of the commodity, and treat the result as a uniform tax rate on the entire amount of the commodity. The Colwyn Committee adopted the last alternative.

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<sup>1</sup> For tea, however, the Colwyn Committee stopped at £200 and above group.—Appendices, pp. 40-50.

With regard to the duties on molasses, glucose and saccharine, the Colwyn Committee credited every family with an equal amount; Sir Samuel ignored these duties.

**Tobacco and Alcohol:** As regards both of these, no consumption statistics were available either in the 1904 or, 1918 budgets. The 1908 Excise Inquiry did cover expenditure in these directions; but the number of families taken was too small to make its results reliable. Both smoking and drinking are matters of individual idiosyncrasy; the expenditure on them varies widely within the same income-group. This made the task of the authors doubly difficult, and taxed all their ingenuity.

With regard to tobacco consumption, Sir Herbert relied on an estimate made speculatively by the Board of Customs and Excise for 1914-15. But as the duty was originally assessed on raw leaf, and the amount of tobacco obtained from a given quantity of raw leaf varied with the moisture it contained, finding out the duty paid by different income-groups was even then difficult. Sir Herbert was lucky enough to get from one Mr. Reade a rough estimate of the rate of duty on retail tobacco usually consumed by the working classes. As the higher varieties of tobacco consumed by the middle and higher classes contain less moisture, a small addition to this rate was made in their case. Matches are mostly consumed by smokers and in the same proportion as tobacco; every family was therefore taken to have contributed by way of match-taxation the same ratio to the total match tax as that borne by its tobacco tax to the total proceeds from tobacco duty.

The Colwyn Committee took as their starting point an estimate given to them for the year 1925 by an individual with an expert knowledge, who had collected data for that purpose from some areas. The estimate related only to £200 income-group, so that for other points on the income scales,<sup>1</sup> consumption and the rate of the duty borne

<sup>1</sup> It is essential to bear in mind here, that while Sir Herbert considered that the maximum tobacco duty was reached at £200 income group, the Colwyn Committee put it much higher—£5,000 for pre-war years and £10,000 for the post-war period.

had to be inferred on general consideration. With regard to the match tax, they adopted the same method as that of Sir Samuel. From the figures of 1923-24 and 1925-26 thus arrived at, they worked back to the other years they had selected.

The alcohol problem presented even graver difficulties. The only detailed investigation as regards its consumption was that made by Messrs. Joseph Rowntree and Arthur Sherwell in 1898. For the purposes of their book, "The Temperance Problem and Social Reform," they had made special inquiries in over 10,000 households, and on the basis of these as well as other collateral evidence, they had come to the conclusion that the average working class family spent not less than 6d. a week on alcoholic liquor. From this starting point, Sir Bernard Mallet assisted by experienced Excise officials had made very careful inquiries, and after a number of elaborate calculations—because alcohol duty depends on the character and alcoholic strength of different kinds of liquor—had arrived at duties paid by the working family, the lower middle class and the income-tax paying class. For allocation among the greater sub-divisions of population that Sir Herbert took, no data were available, and arbitrary allotments had to be made in the light of the general prevailing conditions.

The Colwyn Committee indulged even more in the cobweb of guesswork. In addition to Sir Samuel's resources, they had on their hands the middle class family budgets referred to earlier, and also 319 returns of alcohol consumption from members of the National Co-operative Men's Guild. But they could not see their way to rely on any one of these. They, therefore, fell back upon certain known data, viz., total consumption of spirits, beer and wine, the duty on each, and the approximate number of adult population, male and female, and on this slender basis built up a very complicated structure.<sup>1</sup>

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<sup>1</sup> They arrived first at the consumption of alcohol by three broad divisions of people viz. persons with incomes upto £200, persons with incomes between £200—500, and those with incomes above £500. On two hypotheses

**Miscellaneous Items:** Other smaller taxes like those on coffee, cocoa and chicory, dried fruits, patent medicines, table water and entertainments (levied in 1916-17) were allotted on a rough basis. Sir Samuel took the consumption of coffee, cocoa, and dried fruits from 1904 budgets; the consumption of other commodities was arrived at on general considerations. The total proceeds from these duties were roughly allocated between the various income-groups on the basis of these consumption figures. The Colwyn Committee followed this example except in the case of Entertainments Duty, where they hazarded separate estimates.

### Post Office Receipts

Sir Samuel treated the net post office receipts as a tax. Earlier, Sir B. Mallet had estimated that the income tax paying class contributed 13/18ths of the net post office revenue. On this basis, Sir Herbert allocated arbitrarily this tax among his various sub-groups. The Colwyn Committee refused even to analyse the post office receipts on a technical ground, viz., that they were officially classified as non-tax revenue and therefore outside the scope of their enquiry.

### B—Study by Mr. Jones

#### (i) Tobacco and Alcohol Consumption

Mr. Jones, who read his paper before the Royal Statistical Society, followed for the most part the method of his

*Contd. from p. 225.*

(i) that the percentage of abstainers, male and female, remained the same within all the three income groups and (ii) that the percentage of abstainers varied with the income group—with a common assumption regarding the ratio of consumption of each class of liquor by females to that of males,—and four sub-hypotheses within each main hypothesis as to the ratio for each class of drink between the average consumption of the males of one group to that of males of other income groups, they arrived at eight different results, representing figures of consumption of each income group. Since the duty on beer varies according to its strength, and on wine according to its type, different rates of duties had to be assumed for different groups on a consideration of the habits of those classes. Thus, eight different amounts of duty were obtained for each of the three broad income groups. From these, on practical and statistical considerations, one amount was arrived at for each income group. The further finding out of the duty paid by 10 different groups, which the Committee took for their purpose, had to be done on a speculative basis.

predecessors, introducing slight modifications to suit changed conditions and his greater regard for details.<sup>1</sup> But he made three important changes. He regarded the method adopted both by Sir Herbert and the Colwyn Committee of taking the average figures of tobacco and alcohol consumption for various income classes as fundamentally wrong. He argued that in such cases, where consumption within the same income group varied astonishingly with different individuals, to try to strike a balance by the average process was a dangerous course. It gave a misleading impression of the burden of taxation borne by various classes of people, and was a false guide to tax policies. If a person spent an unreasonably great proportion of his income on such items, and in consequence found that he had to pay an unduly large proportion of his income in taxation, he had only himself to blame. Mr. Jones, therefore, divided each income group into five groups with regard to their tobacco and alcohol consumption, A to E—A representing complete abstinence, E the height of drunkenness. He worked out the taxation figures for each of these groups of every income class.<sup>2</sup>

#### (ii) Changes in Earning

There was also another major change that Mr. Jones made. Both Sir Herbert and the Colwyn Committee had, for purposes of comparison, asked themselves only the question what a representative person of a certain income group would pay by way of taxation in the different years they had selected. For them, the change in wages brought about by the passage of time in their initial income groups did not matter. Mr. Jones, however, concerning himself with the comparison of post-war taxation with pre-war taxation, took into account the change in wages brought about by the war. He did not simply ask how much per-

<sup>1</sup> Both our earlier studies had relegated the duties on coffee, cocoa, chicory, currants and raisins to a heterogeneous group of other duties. Since figures of their consumption were given in 1904 budgets, Mr. Jones treated them on the same basis as tea and sugar duties.—The Journal of the Royal Statistical Society, (1927), p. 692.

<sup>2</sup> *Ibid.*, pp. 687-9.

centage of his income a person earning £100 (to take up one of his income groups) paid by way of taxes in the years 1913-14 and 1925-26. He found out the tax burden on a person earning 21s. 4½d. per week in the pre-war period (i.e., about £55 per annum), and compared it with the tax burden borne by him in 1925-26, when he was likely to earn £100 because of wage rise.<sup>1</sup>

### (iii) Measurements of Benefits

There was one more new idea which Mr. Jones introduced, viz., that of the measurement of benefits received by various groups from Government expenditure. This idea, though not a part of the study of incidence, is so intimately connected with it, that no wise tax policy can be arrived at without giving it proper thought. Sir Samuel had excluded this question because of the great difficulties of the subject and because it was beyond the scope of his enquiry.<sup>2</sup> The Colwyn Committee had shown a greater grasp of the problem, insofar as they had deferred passing judgment on the existing distribution of taxes without taking into consideration the direction of Government expenditure.<sup>3</sup> It was left to Mr. Jones to try to measure the benefit of Government services<sup>4</sup> and thus furnish data for a more enlightened judgment.

## C.—Mr. Sandral's Study

### (i) Inclusion of Stamp Duties

Mr. Sandral's analysis of tax burdens differed from earlier studies in only two important points. He held that to ignore stamp duties, which produced £12 millions even in 1918-19 and more than double that amount in 1925-26 and 1930-31,<sup>5</sup> as the three earlier studies had done, was to vitiate the final picture. He, therefore, decided to include them. But there being no data for their allocation, he had

1 The Journal of the Royal Statistical Society, (1927), p. 691.

2 *Ibid.*, 1919, p. 151.

3 Report, para 220.

4 Journal of the Royal Statistical Society, 1927, pp. 707-710.

5 *Ibid.*, 1931, p. 84.

to resort to some arbitrary method. He thought of three alternative assumptions: (i) that each person contributed equally to these duties in the same way as he contributed to income tax and super tax, (ii) that every person paying income tax contributed equally to these duties, and (iii) that every income-tax paying class bore the burden of these duties proportionate to its total income. The first method, he thought, exaggerated much the burden on higher incomes, the second seriously underestimated it. He therefore, chose the last alternative.<sup>1</sup>

### (ii) Problem of Differential Duties

The other important point, on which he ranged himself against his two predecessors, the Colwyn Committee and Mr. Jones,<sup>2</sup> was regarding the burden of differential duties. He calculated the incidence of such duties on consumers, as if the higher rates of duty were levied on the entire amount of the commodity.<sup>3</sup>

### (iii) Luxury Taxes

The changes in the tax structure that had taken place after the making of the earlier studies presented a difficult problem to Mr. Sandral. In 1930-31 there were many taxes on luxuries, e.g., taxes on petrol, silk, artificial silk, motor cars, etc. The 1904 budgets being confined to the working classes supplied no data regarding the consumption of these commodities. Mr. Jones cut this Gordian knot by assuming that taxes on motor cars and petrol were paid by the income-tax paying classes in proportion to their income (the way in which he treated the stamp duties), and that the other Mckenna Duties and the silk and rayon duties were spread over the community proportionately to the tax burden on alcohol and tobacco.<sup>4</sup>

1 Journal of the Royal Statistical Society, (1931), p. 87.

2 Sir Samuel had no such problem, as in his years there was no Empire preference.

3 Journal of the Royal Statistical Society, 1931, p. 89.

4 *Ibid.*, p. 89.

### D. Swedish Study

The estimate made for the Swedish Government<sup>1</sup> is on a somewhat different basis from others. Broadly speaking it represented the emergency tax structure of 1931, but without death duties. The more important difference between this and the previous studies is the inclusion of local rates in its estimates.

### E—Shirras' and Rostas' Study

This study was planned mainly to bring up-to-date the estimates of previous enquiries. But in attempting to carry out the plan, because of the complication of the modern tax structure introduced mainly in thirties, the authors had to face new problems, and had to evolve new methods to tackle them. The large increase in rates of direct taxation brought to light a grave mistake committed in the original calculations regarding death duties, and this had to be corrected. In addition, the various budget studies made in the last decade in England and other available data provided new valuable information. These make the study novel in many respects.

#### (a) Death Duties

The assumption made in all earlier studies in calculating the burden of estate duties had been that the deceased had saved enough during their lifetime to leave to their successors after estate taxation the same amount of estate as they had themselves inherited. It would have been more scientific to find out what exactly the savings of different property-owners were, and calculate estate duties on this basis. But no such figures being available, this assumption seemed the simplest, and was adopted. Messrs. Shirras and Rostas, calculating the burden of Estate Duties for 1937-38 and 1941-42 on this basis, found that at a certain income level this assumption broke down, because the

<sup>1</sup> In the absence of an English rendering of this work, we have relied on the account of Mrs. Hicks, "The Finance of British Government, 1920-36" p. 272.

combined burden of income tax, surtax and death duties amounted to more than 100%.<sup>1</sup> It was only, then, that hard thought was devoted to finding out an alternative method, Mr. Nicholas Kaldor of the London School of Economics suggested a way out—the adoption of the "annuity" method. According to it, the burden of estate duties = the present value of the income tax, surtax and death duties that the estate would have to pay now—the present worth of all future income and surtax payments that the estate would have paid in absence of death duties. The fact that death duties were levied meant that if no net savings were made during the lifetime of the deceased or if the savings were less than enough to pay death duties, a part of the estate would have to be sold and the remaining would contribute less by way of income tax and surtax in future. The earlier methods of calculating death duties, where no allowance was made for any reduction in the value of the estate, overestimated their burden except in the special case where enough was saved during lifetime to keep the estate intact at death. The percentage burden on the unearned income from the estate was the same as that on the total value of the estate. The burden, calculated on the assumption of zero net savings by property-owners, was called the Minimum Burden of Death Duties. Mr. Kaldor also made another calculation on a different assumption regarding savings, viz., that all possible efforts were made by the estateowners to save an amount sufficient to maintain the net income of the estate constant over successive generations. At the lower ranges of unearned income, where this was possible, this second assumption was the same as that made by the Colwyn Committee. But in the higher ranges of income, where any effort to keep the capital intact would have meant a

<sup>1</sup> E. G. the annual burden of death duties on investment income of £50,000 was 108.1% in 1941-42: *The Burden of British Taxation*, p. 77. A similar result had been obtained by Mr. Sandral regarding the total tax burden on £50,000 incomes (*Vide Appendix J*), but he had paid no heed to this.

net income smaller than that obtained from less savings, the assumption made was that savings made out of annual income were equal to savings on "optimum" estates i.e., estates out of whose income it was just possible to save at annual rate in such a way that the accumulated savings were sufficient to pay death duties.

This new method of calculating the burden of Estate Duties brought into greater prominence a number of assumptions on which the burden of death duties was calculated. Some of these have already been seen earlier in this chapter; but in addition, the new method rested on two further assumptions, viz., that the rates of income tax, super tax and death duties would continue *ad infinitum* as before, and that every time the estate would be inherited by a single person.<sup>1</sup>

In addition to this fundamental change in the method of calculating Estate Duties, Mr. Kaldor also refined some other earlier assumptions to bring them in greater conformity with reality. E.G. the Colwyn Committee had assumed arbitrarily that every property-owner took out an insurance policy at the age of 45. Mr. Kaldor, proceeding on the scientific basis that the age chosen must be such as to provide an expectation of life corresponding to the average length of a generation, put this age at 38. In earlier studies, taking out of an insurance policy was thought of as the only method for providing for death duties. In cases where the income is not subject to the full standard rate of income tax, direct accumulation is more profitable than taking out an insurance policy; in these cases, therefore, the burden was calculated by Mr. Kaldor on direct accumulation method. In accordance with cheaper money prevalent now, the rate of interest was taken to be lower, viz., 4%. Slight changes were also

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<sup>1</sup> This assumption, though rather far from reality, does not much vitiate the conclusions because it affects only the amount of death duties paid two generations i.e. 62 years hence.—Shirras and Rostas, pp. 90-93.

introduced in computing the burden of Legacy and Succession Duties; but these do not concern us here.

### (b) Greater Comprehensiveness

Generally, a tax is taken to exclude all contributions, whether voluntary or compulsory, which have a *quid pro quo* basis. This study by Shirras and Rostas took into account all compulsory contributions with or without corresponding benefits, and all possible methods were utilized to allot these. The result was that items like Social Insurance were also allocated among various income groups. In addition, duties like Stamp Tax, Motor Vehicle Taxation, etc. were scientifically assigned for the first time by dividing them into taxes on production in general, and taxes on personal incomes. Taxes on production and on businesses, and the purchase tax (levied during the war) were allocated among various income groups according to their expenditure on broad categories of income like foodstuffs, goods, services, etc. Only two major taxes were excluded, viz., local rates, as there were no sufficient data on the basis of which these could be allotted, and business taxes as there was no possibility of assigning these among individual incomes. The burden of the undistributed profits tax<sup>1</sup> was calculated on the assumptions that persons belonging to the same income-groups derived equal proportions of income from companies and that all companies kept the same ratio of distributed to undistributed profits. Since in this connection the rights that a person had in the reserves of the companies in which he held shares were considered as a part of his income, the burden of this tax had to be related not to statutory but to "imputed" incomes, i.e., statutory income plus the income in the form of company reserves. A side table was constructed to show the tax burden (including that of undistributed profits tax) on the imputed incomes. The burden was not however included in the final tables. The study was able to cover 82% of compul-

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1. In 1941-42 in addition to this tax there was the N. D. C. and the E. P. D. No effort was made to calculate their burden.

sory contributions in 1937-28 and 70% in 1941-42. On the definitions and methods of the Colwyn Committee only 52% of all compulsory contributions would have been covered.

### (c) Avoidable and Unavoidable Tax Burden

Another new concept that this study introduced was that of dividing taxes into two main categories—unavoidable and avoidable. Unavoidable taxes are those, whose payment can be hardly avoided like income tax, super tax, employees' insurance contributions, taxes on essential commodities like sugar, tea, wheat, coal, postal services, etc. and death duties.<sup>1</sup> Duties paid on consumption of unessential goods like tobacco, alcoholic drinks, entertainments, etc., are "avoidable." The calculations regarding unavoidable burden are accurate and more representative, and were therefore made for different sizes of the family. The avoidable tax burden figures are more speculative, and wide deviations from it were possible in individual cases. Hence, no different calculations were made in their case for different sizes of the family; in their case all calculations pertained to the standard tax-paying family, husband, wife and two children. In case of all commodities, where wide individual variations were possible, a moderate amount of consumption was assumed.

## II—Studies in U.S.A.

The importance of the problem of the measurement of tax burdens on various classes of people has not remained unrealized in U.S.A. Apart from the studies on the incidence of individual taxes, in which U.S.A. abounds, there have been four studies on the burden of the tax system as a whole—two for the New York State,<sup>2</sup> one for New York

<sup>1</sup> It is surprising that while in the definition of unavoidable taxes, death duties were included (p. 19), in the calculation of unavoidable tax burden these were excluded (pp. 39-50).

<sup>2</sup> Report of the New York State Commission for the Revision of Tax Laws (1932), pp. 93-100, and *Ibid.* (1933), pp. 21-23.

and Illinois,<sup>1</sup> and one for the whole of U.S.A. The first two studies were designed more to indicate the difficulties of the problem rather than to measure the actual tax burden; the fourth attempts to assess the burden on a particular income group (viz. \$2500) only and omits federal taxes.<sup>2</sup> We shall, therefore, confine our attention to the third study.

### Their Complexity

Before proceeding with an examination of this study, in fairness to it, it is essential to remember the complexity and sometimes even the idiosyncracy of the American tax structure. The tax system in U.S.A. permits many devices by the taxpayer to decrease his tax liability. This, coupled with the prevalence of many taxes whose incidence is uncertain, compels the incidence studies to adopt different alternative hypotheses. Moreover, the wide prevalence of taxes like the sales tax,<sup>3</sup> the corporation tax, and the greatly defective property tax<sup>4</sup> force the studies to have different estimates for persons earning the same income in different ways. We should not, therefore expect in American studies the thoroughness and the convincing simplicity that we have met with in British works.

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1 Estimate of the Tax Burden on Different Income Classes—Mabel Newcomer in *Studies in Current Tax Problems* (The Twentieth Century Fund), pp. 1—52.

2 Leonard—*The Direct Tax Burden on Low Income Groups*.

3 Since the farmer consumes a part of his farm produce, he pays less tax in proportion to his consumption.

4 These defects were threefold:—(a) Form of the tax:—The tax is in some states levied on realty only, as in New York State; in some it is levied on all property including intangibles. (b) The defects of administration, some of them easily curable, others almost incurable: The ratio of assessed property value to actual property value varies astonishingly even in the same state with different forms of property (realty, personal tangibles, and intangibles), the size of property (big or small), and the situation (urban or rural). (c) Inherent defects: Even when there is a uniform property tax on all forms of property and the assessment is perfect, property valuations do not always represent capitalized net income from it, e.g. with small businesses and with farm property, value of property is far more. See *Taxation Issues*, Kendrick, pp. 49-78, Leeland—“The General Property Tax” in Fagan and Macy—*Public Finance*, pp. 277-293.

### Newcomer's Study

Mabel Newcomer, attempting to assess the total tax burden, federal, State and local, in New York and Illinois in 1934, took ten different groups: three farmers earning \$500, \$1000 and \$2000 respectively, two wage earners earning \$1000 and \$2000, two salaried workers with incomes \$5000 and \$20,000, a merchant making \$5000 and two corporation officials with \$100,000 and 1 million dollars.<sup>1</sup> She had also to assume the different sources from which the representative person of each group derived his income. For the sources of incomes of groups earning 20,000 and over, she relied on the Statistics of Income of 1934.<sup>2</sup> Persons with income from corporations were assumed to have bought stock only of domestic manufacturing corporations, so that special taxes on other types of corporations could be omitted. The amount spent and saved by these groups were obtained from "America's Capacity to Consume"<sup>3</sup> and the details of expenditure were suggested by various existing budget studies.<sup>4</sup> With her many other assumptions and detailed calculations, we are not concerned here, except for her interesting treatment of Customs' Duties, which were disposed of on the assumption that each consumer's share to them was in proportion to his expenditure on tangible personality.<sup>5</sup> Miss Newcomer was fully aware of the questionability of this assumption, as only a small part of the consumer's purchases consisted of products from foreign countries, and the rates of taxes on imported products varied. But since there was no possibility of more definite calculations some assumptions had to be resorted to, and she thought that this assumption was, under the circumstances, most reasonable.<sup>6</sup>

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1 Studies in Current Tax Problems, p. 4.

2 *Ibid.*, p. 3.

3 *Ibid.*, p. 4.

4 *Ibid.*, p. 5.

5 *Ibid.*, p. 17.

6 *Ibid.*, p. 18.

### Basic Assumptions

The basic assumptions on which tax estimates were based<sup>1</sup> are of greater moment to us, as illustrative of the way in which the complications created by a complex tax structure can be tackled.

(i) **Income Tax:** The American income tax, in addition to the complexities of the English income tax, has one more complication, viz. that it is left to the option of the taxpayer to file a joint return for himself and his wife or a separate return.<sup>2</sup> Though for a salaried worker of \$5000, the filing of separate returns will make little difference to the amount of income tax to be paid, for workers with higher incomes and for other groups the difference is appreciable. Therefore, for these groups two alternative estimates were made, one on the basis of joint returns in series I to IV, and the other on the basis of separate returns in series V. The incidence of this tax was assumed throughout to be on the taxpayer.<sup>3</sup>

(ii) **Death and Gift Taxes:** The incidence of estate and inheritance taxes was supposed to be on the deceased, and was calculated in the same way as in the earlier English studies. To allow for the evasion of death duties through liberal gifts during lifetime, two assumptions were made—(a) that the taxpayers other than \$5000 salaried worker would, rather than pay more tax, risk division of property with their wives, and make substantial gifts to children (Series I to IV), and (b) that rather than risk anything they would choose to let more go into the coffers of the Government.<sup>4</sup>

(iii) **Property Tax:** The incidence of the property tax is a difficult problem. Whether it will be borne by the present taxpayer, or is capitalized or shifted, depends on

<sup>1</sup> These assumptions have been briefly summarized in Table A-7, *Studies in Current Tax Problems*, p. 11.

<sup>2</sup> In U.K. also the spouses can choose to file separate returns. But since the incomes of both will be taxed at a rate appropriate to the total income, their choice will not mean any difference to the Treasury.

<sup>3</sup> *Studies in Current Tax Problems*, pp. 10-11.

<sup>4</sup> *Ibid.*, pp. 10-12.

a number of circumstances difficult to ascertain in actual life. Various assumptions had, therefore, to be made regarding different classes of property. With regard to the land tax, it was assumed that either the whole of it would be capitalized, or only one-half capitalized the remaining half being borne in the same way as the tax on improvements. The tax on improvements and personality in the hands of the final consumer was supposed to be borne entirely by him. The tax on business improvements and personality was assumed to be either shifted entirely to the ultimate consumers of the goods and services produced by business, or shared fifty-fifty by the taxpayer (if the taxpayer be a corporation, by the stockholder) and the final consumers.<sup>1</sup>

(iv) **Sales Tax:** Three assumptions were made regarding its incidence (a) That the tax was shifted entirely to the final consumers; (b) that half of it was shifted, and the other half borne by the taxpayer; and (c) that half of it was shifted to consumers, and the other half divided equally between the merchants and the producers.<sup>2</sup>

(v) **Automobile Taxes:** In so far as the cars were for personal use, it was assumed that the taxpayer would bear the burden of the automobile licence and gasoline taxes. To the extent that they were used for business purposes, two alternative estimates were made—one on the assumption that they were entirely shifted to the purchasers of the farmers' and merchants' goods, and the other on the hypothesis that only half the tax would be so shifted the other half sticking where it was laid.<sup>3</sup>

(vi) **Corporation Taxes:** The incidence of the general corporation taxes was supposed to be equally on the stockholders and the customers. The taxes on gross receipts of public utilities were assumed to be shifted either wholly or in part to the final consumers. The federal taxes on capital stock, net income and undivided profits, and the

1 Studies in Current Tax Problems, pp. 12-13.

2 *Ibid.*, pp. 13-14.

3 *Ibid.*, pp. 14-15.

other state taxes of the same nature on corporations were assumed to be borne by the stockholders in proportion to their holdings.<sup>1</sup> The federal corporations excess profits tax was omitted as the corporations, from which the various income groups derived their incomes, were supposed to have no excess profits.<sup>2</sup>

(vii) **Financial Transaction Taxes:** All these taxes were assumed to be borne as intended, the stock transfer taxes by sellers of securities and the New York mortgage tax by the mortgagor.<sup>3</sup>

(viii) **The Payroll Tax:**<sup>4</sup> It was assumed to be shifted either entirely to consumers, or borne equally by the owner of the business, the employee, and the consumers. The employee was brought in, because this tax could be reduced by lower wages or by displacing labour by machinery.<sup>5</sup>

### Characteristic Caution

It is an extremely characteristic trait of the American studies, that inspite of these five assumptions and five alternative estimates based on each of them, Newcomer is at great pains to point out that these assumptions only concern the shifting of taxes or the usual changes in the ownership of income and property within the family made in order to reduce taxes.<sup>6</sup> Different, though reasonable, assumptions concerning the amount and nature of each group's income, property and expenditure would considerably affect the calculations. The estimates, therefore, could be used only to a very limited extent as a basis for judging the existing tax system.<sup>7</sup>

### Potential Income

Another very interesting point in this study is the conception of "potential income." When calcu-

1 Studies in Current Tax Problems, pp. 15-16.

2 *Ibid.*, p. 20.

3 *Ibid.*, p. 15.

4 For a short account of this, see *Facing the Tax Problem*, pp. 17-18.

5 Studies in Current Tax Problems, p. 16.

6 *Ibid.*, p. 7 and p. 10.

7 *Ibid.*, p. 1.

lating the tax burden as a percentage of income, Miss Newcomer does not relate the taxes paid to the actual income, but to the income as it would have been in the absence of certain taxes like the tax on corporation profits, land tax, etc. Where land tax is capitalized, the price of the land is lowered. The buyer invests the difference in securities; his actual income, therefore, is more than the income he would have obtained otherwise. If corporation taxes were not levied, to the extent that these are borne by the stockholders, dividend payments would be higher. Where the sales tax is not shifted to the consumers, the farmers and the merchants earn less because of the tax payment. All factors are taken into account in calculating potential income. The indirect losses of merchants and the farmers through a decrease in their sales because of the sales tax are, however, not taken into account.<sup>1</sup>

### III—Some Problems in Measurement

This short account of the important incidence studies brings out glaringly the variety of methods that have been used and must be used to cope with problems created by different tax systems and the different data available on the subject. Thus, there is no ideal method, and the comparison of one with another used in a different clime and time so as to bring out the superiority of one over the other is unprofitable and unscientific. Nevertheless, there are certain common questions that they have all tackled, and it may be possible by a critical examination of their methods<sup>2</sup> to ascertain the best method under given conditions.

#### (a) Group versus Average Method

The first question, we propose to discuss, arises in connection with the very interesting way in which Mr. Jones treated alcohol and tobacco consumption by division of each income class into groups, and by providing separate

1 Studies in Current Tax Problems, p. 22 and p. 81

2 We have taken here only the points of controversy. The fundamental unity of method, that underlies the great diversities, is too ingrained to need any discussion.

estimates for each group.<sup>1</sup> This treatment, though confined here only to these two commodities, can easily be extended to all taxable items, whose consumption varies widely within the same income group. Is this course advisable? We submit it is not so. Though it may be a model of arithmetical accuracy to give as many estimates for each income group as there are variations in the habits of expenditure,<sup>2</sup> they are worse than useless for our purpose. The incidence studies are meant as a guide to tax policy. Since taxes must pay at least some obedience to the rules of simplicity and uniformity, no tax system can be adjusted to all such variations. We must therefore rely on the device of taking the consumption of the representative person of each income group. The arithmetical average usually furnishes the best method for this purpose. It may be conceded that extreme fluctuations detract much from the value of the arithmetical average. Its adoption in cases of widely varying consumption may give an entirely false idea of the consumption of various income groups and the taxes borne by them. In such cases, the method of the mode or some other suitable method should be used. The "group" method adopted by Mr. Jones, unless further accompanied by the knowledge of the number of families each group contains, is of little value; when so accompanied, it is much better to show in the final table the tax burden on the representative group only. Mr. Jones perhaps realized this,<sup>3</sup> and it was only because he had not at his disposal the relevant data, that he was satisfied with his method. But even in that case, the method marked little advancement.

<sup>1</sup> Messrs Shirras and Rostas have also divided each income group into three classes regarding its tobacco and alcohol consumption—light, moderate and heavy. But in the final tables, only a moderate consumption of these is allowed.

<sup>2</sup> The logical conclusion will be a separate tax estimate for each fellow—*Vide New York State Commission (1932), p. 94.*

<sup>3</sup> "I think our concern should be with the ordinary consumer rather than with extraordinary, allowing fair latitude, of course, to the term 'ordinary' so that it shall take in the majority of men."—*Journal of the Royal Statistical Society (1927), p. 689; also, p. 686.*

### (b) Income Changes

Another controversial point that Mr. Jones raised was whether the changes in incomes during the years selected for comparison should be taken into account. The other English studies we have seen do not concern themselves with this.<sup>1</sup> Much depends on the purpose of the inquiry undertaken. If its aim is to compare the burden on one class, say, the unskilled working class in a certain year with that borne by the same class in another year, it is essential that wage changes must be considered. But where the purpose is to compare the burden on a particular income group in one period with that on the same income group in another, the changes are irrelevant. The first type of the study is more difficult and requires far more data than the second, but is more lifelike. The second is more formal, but by attaching, if possible, a table to it showing the number of families falling in each group in the two different years, it can be made to convey a faithful and lively impression of reality.

### (c) Inclusion of Local Taxes

The inclusion or exclusion of local taxes is another point treated differently by various studies. Sir Herbert was concerned only with post-war problems of public finance, and the local taxes had not been much influenced by the war. Moreover, as regards their real incidence, the economists were much less agreed than as regards national taxes.<sup>2</sup> Sir Herbert, therefore, ignored them. The Colwyn Committee also took no account of them; but they were not careful enough to mention the grounds for this exclusion. Perhaps, they thought the exclusion was too axiomatic to need a discussion, or perhaps the subject of local tax was outside the scope of their inquiry as they had been asked to report on national taxation only. Mr. Jones, who soon followed, pursued the same course; but in the discussion that ensued after the reading of his paper, he

1 In U.S.A. studies since only one year is chosen the point does not arise.

2 *Vide* his article in *The Journal of the Royal Statistical Society*, (1919) 150.

came in for a lot of criticism for this.<sup>1</sup> M. Sandral also omitted local taxes. The Swedish estimate was the first post-war study to take into account the British local taxes. Messrs Shirras and Rostas were whole-heartedly in favour of including the burden of local rates, but owing to lack of data, they had to omit from their calculations the most important local tax viz. local rates. The U.S.A. studies are unanimous in taking local taxes into account.

We believe that at the present stage, it is best to ignore local taxes inspite of their increasing importance. The incidence of most of them is still largely controversial. A study of burden of local rates on any income group must, of necessity, classify income groups further by localities, and unless the local tax policies are fairly uniform, this is a formidable task. The unfairness of comparing the burden of national taxation in one state with that in another, has been widely recognized.<sup>2</sup> This holds much more true regarding comparison that we will have to make between the burdens in different local areas, as the varieties of services rendered by local bodies are great. In national finance, the figures of burden, even if not of much value for comparative purposes, have an absolute worth because of the well-known principle by which they can be judged. There being no such principle with regard to local taxes, the figures will have no meaning, unless combined with benefit calculations. With our present stage of technique, this is not possible. Hence it is best to leave local taxes out of account.<sup>3</sup>

#### (d) Differential Rates

The fourth question of importance raised by Sandral was with regard to the question of differential rates. Relying on a dictum of Marshall, that wherever differential duties exist, the consumers pay tax at the higher rate, and the rebate goes to enrich the favoured producer, he cal-

1 Journal of the Royal Statistical Society (1927), pp. 719, 721, and 722.

2 Report of the Indian Taxation Enquiry Committee, para 478.

3 This applies with even greater force to compulsory contributions accompanied by corresponding benefits.

culated taxes at the higher rate in case of commodities receiving Imperial Preference. The Colwyn Committee, it will be remembered, took an entirely different view; and Jones and Shirras and Rostas followed them.<sup>1</sup> The problem, it must be borne in mind, is not one of price rise. It is agreed to by both the sides that except where the part of the commodity taxed at the higher rate forms an insignificant proportion of the total produce, the rise in price of the commodity concerned will equal the higher rate of duty. The problem is whether this entire price rise is covered by "incidence," or whether "incidence" is a narrower concept covering much less. To our mind, as already indicated earlier, incidence calculations are only a device to find out the contributions of various classes to the Exchequer. Therefore, the burden of any price rise, to the extent that it does not benefit the government, must be ignored in incidence estimates.<sup>2</sup>

<sup>1</sup> The latter, however, deviated from their stand in case of sugar. *Vide* The Burden of British Taxation, p. 118.

<sup>2</sup> As Miss Newcomer points out, the higher duties are a question not of tax policy, but also of trade policy.—Studies in Current Tax Problems, p. 15.

## CHAPTER X

### MEASUREMENT OF TAX BURDEN IN GUJARAT

Having seen in the previous chapter the methods adopted in two leading countries of the world to calculate the tax burdens on various income groups, we are now in a position to review the studies made in India, and to evolve a suitable method to calculate the tax burden on various income groups in India, by trying to measure it in a selected area, viz. British Gujarat.

#### I. Past Attempts

##### Indian Taxation Enquiry Committee

The honour of making the first attempt in India to measure the burden of taxation on various classes of people<sup>1</sup> goes to the Government of India. The resolution of the Finance Department, that contained the Government's direction to the Taxation Enquiry Committee, had as its first item: "to examine the manner in which the burden of taxation is distributed at present between the different classes of the population."<sup>2</sup> The Committee were also at first empowered to "institute such an enquiry into the economic condition of the people as they might consider necessary for their purpose, and to report on the adequacy of material already available, making suggestions as to the best manner in which it might be supplemented and the most suitable agency for a wider economic inquiry."<sup>3</sup> The latter part of the task was afterwards delegated to the Economic Enquiry Committee, the Taxation Committee being specifically asked to suspend any such enquiry until a report had been submitted by the Economic Enquiry Committee. By the time the latter submitted a report, the

<sup>1</sup> One D. Barbour, a member of the Bengal Civil Service, had made an "Inquiry into the Incidence of Taxation in British India" in 1881, but this was confined to ascertaining the per capita burden in different provinces.

<sup>2</sup> Report of the Indian Taxation Enquiry Committee, para 1.

<sup>3</sup> *Ibid.*, para 479.

Taxation Committee had finished their enquiry and were drafting their report, so that the institution of a special inquiry was rendered impossible.<sup>1</sup> The Committee were, thus, compelled to base their conclusions on the existing meagre material. Instead of dividing population into income groups, they were forced to divide it into ten broad classes: (i) the urban labourers including the lower grades of urban artisans, (ii) the landless agricultural labourers and the lower grades of village artisans, (iii) the small holder, whether ryot or tenant, (iv) the peasant proprietor with a substantial holding, generally in temporarily-settled areas, (v) the large landholder, generally in the zamindari areas, (vi) the petty trader, in the village and the town, (vii) the larger trader, generally in the town, who is subject to income tax, (viii) the big merchant class, (ix) the clerical class, including the subordinate ranks of Government servants and the lower ranges of professional men not subject to the income tax and (x) the upper professional classes.<sup>2</sup> The Committee attempted to give the money burden of taxation including local taxes with regard to the first two classes by dividing the proceeds from the taxes that affected them by their total number.<sup>3</sup> With regard to the remaining groups, in the absence of income and expenditure studies, even a rough guess as to the money they contributed to Government coffers was not possible, and the Committee had to be content with a few remarks of a general nature.<sup>4</sup> Whenever possible, they also tried to compare the post-war burden on various classes with that before the war. Compared with the studies of incidence of taxation in other countries, this study is so defective, that it is hardly worthy of further examination.<sup>5</sup>

#### Professor Shah and Mr. Khambata

The next important inquiry was that made by Professor K. T. Shah and Mr. Khambata, who worked out the tax

1 Report of the Indian Taxation Enquiry Committee, para 479.

2 *Ibid.*, para 481.

3 *Ibid.*, paras 482-483.

4 *Ibid.*, paras 483-492.

5 The Committee, it seems, were keenly conscious of the very limited value of their study—Report, paras 480 and 493.

burden for 1923-24.<sup>1</sup> They divided taxpayers into two classes—the rich and the poor—the latter living just on or below the margin of average income, and the former relatively better off. They allocated the revenues of the Central and Provincial Governments between these two classes on general considerations. Beside other errors in this work, e.g., considering the gross revenues of the post offices and railways as taxation, the division of the people into two very broad classes, viz. the poor and the rich, deprives this attempt of a methodological value for our purpose.<sup>2</sup>

### Economic Adviser's Attempt

Twelve years after the submission of the Indian Taxation Enquiry Committee Report, the attention of the Central Government was again drawn to the importance of this problem. During the Assembly discussions that took place on the Finance Bill, 1938, Mr. L. C. Buss, a nominated non-official member, stressed the paucity of accurate data on which only the correctness of a tax policy could be judged. He suggested that the services of the recently appointed Economic Adviser should be utilized to examine the possibilities of seeing whether "anything can be done to get out some reliable information that would show how the burden of taxation in India is distributed."<sup>3</sup> Sir James Grigg, the then Finance Member, promised to follow up this matter.<sup>4</sup> In accordance with this, directions were issued to the Economic Adviser. The cost and the trouble involved in the task were, however, felt to be so great that after some preliminary efforts the task was given up:

### Our Task

Thus the problem of measuring the tax burden on various classes of Indian people has not been satisfactorily tackled so far; and we have to begin entirely afresh. Any attempt on the part of an individual to solve the problem on an all-India scale is out of question. Customs and Excise Duties, which form a significant portion of the total

1 Wealth and Taxable Capacity—pp. 289-91.

2 For a detailed criticism, see Adarkar—The Indian Fiscal Policy, pp. 567-568.

3 Legislative Assembly Debates, 1938, p. 1650.

4 *Ibid.*, p. 1656.

tax burden, cannot be allocated except on the basis of family budgets. Unfortunately, no budget studies are available except for a few parts in the Bombay Province and the Punjab.<sup>1</sup> If we were, therefore, to avoid being content with a few vague generalisations, we had to confine ourselves to a region from which in course of a short period we could secure a sufficient number of budgets to give us a reliable idea of the consumption habits of various groups within it. British Gujarat, we thought, was such a region. While the calculations of the burden of taxation on various groups in British Gujarat cannot, by themselves, be expected to throw any important light on the taxation policy as a whole, a fruitful line of inquiry will be opened. The study may serve as an incentive and a guide to other similar regional studies, the collective result of which may be of much help in the formulation of a just tax policy.

As we have already seen, the two earlier studies in incidence have little value as regards method. We are, therefore, forced to draw upon foreign studies only, especially British studies, for the tax structure in India greatly resembles that in the United Kingdom. The diversity which we have noticed even among the best of them must make us tread our path with great caution. Besides, the great difference in Indian conditions makes the application of foreign methods specially hazardous. We have to be on our guard throughout, and ask ourselves at every step whether there is anything in the Indian circumstances which makes this application inappropriate.

## II. Our Method

### Differentiation Between Urban and Rural Income Groups

The most important point of departure, that we have to make from British practice in the light of Indian conditions, is the preparation of separate estimates for rural and urban incomes. The English studies do not differentiate between townsmen and village-folks. The one U.S.A. study, which we have critically examined, does distinguish

<sup>1</sup> We do not deal here with the defects of these budgets for purposes of tax calculations, as in absence of other similar budgets the question is of little importance.

between farmers and wage earners earning equal incomes.<sup>1</sup> *A priori*, the British system has much in its favour, for the governments must generally follow a uniform tax policy with regard to both urban and rural incomes. The one very important exception to this uniformity of treatment has been the special taxation of agricultural incomes. But in both U.K. and U.S.A. this method of differentiation has been long given up.<sup>2</sup> Because of the relatively small part played by village economy in Britain, and also because of the striking resemblance between the expenditure patterns of villagers and citizens belonging to the same income group, this method of having only one estimate is more than a convenient abstraction. In U.S.A., the sales tax adopted in most of the States does not apply to the food produced for himself by the farmer;<sup>3</sup> the property tax, both due to its inherent nature and its anomalies, falls unequally on equal incomes earned through different sources.<sup>4</sup> Moreover, the role of villages in U.S.A. is more important; the expenditure habits of farmers and city-dwellers of the same income are very different.<sup>5</sup> Hence, the custom of having two separate estimates in U.S.A. In all these aspects India resembles U.S.A. more than U.K.; in fact, the conditions in India go much further. The governments seem wedded to the policy of marking out agricultural incomes for a different policy from that adopted for other incomes under the income tax laws. An astonishingly great proportion of the Indian population lives on agriculture; a greater number still lives in villages. The difference in the consumption habits of the citizens and villages is large. Hence, we have far more powerful reasons for differentiating between rural and urban folks.

Let us proceed with the question of urban incomes first.

<sup>1</sup> Studies in Current Tax Problems, p. 4.

<sup>2</sup> The options given to the English farmer before the War did to some extent make difference, but as we have seen the differentiation has been much reduced by the Finance Act, 1942, and there is little possibility of its revival in its pre-war form.

<sup>3</sup> In States, where food is exempt from sales tax, this is not an important factor.

<sup>4</sup> Studies in Current Tax Problems, p. 33.

<sup>5</sup> *Ibid.*, Table A-12 on p. 24 and A-14 on p. 26.

### A. City-Dwellers

#### (a) Income Tax and Super Tax

The easiest taxes to be measured are the Income Tax and Super Tax. Many of the difficulties, that confronted studies in other countries when relating these taxes to the amount of income, are absent in our tax system. Our income tax law, as we have seen, knew of no differentiation between earned and unearned incomes upto April 1945, and pays no heed to the greater needs of the married and the family man. The only exemption given is that of life insurance premium upto a certain extent. We have, however, difficulties of our own. The anomalies of our Income Tax Law such as the treatment it administers to the unregistered partnerships, joint families, etc., cannot be taken account of in our calculations; these do not matter much. More important is the exemption of income from agriculture. The income that an urban dweller derives from agriculture bears no definite relation to his income from other sources. It varies widely with individuals and with locality (the smaller the city, the greater the proportion that agricultural income will bear to total income). Therefore, the U.S.A. expedients of laying down along with the group the sources from which the representative person of that group derives his income furnish us no model. We are, therefore, forced to assume that our city dwellers derive no income from agriculture.<sup>1</sup>

The rates of Income Tax and Super Tax for individuals for the year 1938-39 are given below:—

Income Tax Rates for 1938-39

When total income Rs.	2,000 or upwards but less than Rs.	5,000	6½ pies in the Re..
" "	5,000	10,000	9½ "
" "	10,000	15,000	13 "
" "	15,000	20,000	17½ "
" "	20,000	30,000	20 7/12 "
" "	30,000	40,000	24 11/12 "
" "	40,000	1,00,000	27 1/12 "
" "	1,00,000 or upwards		28 1/6 "

<sup>1</sup> It must also be remembered that even in India as in Great Britain the tax on incomes includes that on undistributed profits of the companies. The proceeds from this cannot be allocated.

### Super Tax Rates for 1938-39

For the first 30,000 Rupees		Super Tax Rates for 1933-34		Rates	
For every rupee of the next		20,000 rupees of income	...	Nil.	pies in the Rupee
"	"	50,000	"	16 $\frac{1}{2}$	"
"	"	50,000	"	22 $\frac{1}{2}$	"
"	"	50,000	"	29 $\frac{1}{2}$	"
"	"	50,000	"	35 $\frac{1}{2}$	"
"	"	50,000	"	42 $\frac{1}{2}$	"
"	"	50,000	"	48 $\frac{1}{2}$	"
"	"	50,000	"	55 $\frac{1}{2}$	"
"	"	50,000	"	61 $\frac{1}{2}$	"
"	"	50,000	"	68 $\frac{1}{2}$	"
"	"	50,000	"	74 $\frac{1}{2}$	"
"	"	50,000	"	81 $\frac{1}{2}$	"

In calculating the burdens of these taxes on various income groups, it must be remembered that they are calculated to the nearest anna. The prevalence of the step system had necessitated a provision in the Income Tax Law that where owing to the fact that the total income of any assessee had reached or exceeded a certain limit, he was liable to pay income tax at a higher rate, the amount of tax that he was to be charged was to be not greater than the aggregate of (a) the amount of tax payable, if his total income had been a sum less by one rupee than that limit, and (b) the amount by which his total income exceeded that sum. The burden borne by various incomes is given below:—

Income	Income and Super Taxes
Rs.	Rs.
2,000	1 0 0
5,000	170 4 0
10,000	508 12 0
15,000	1,016 0 0
30,000	3,217 1 0
50,000	8,068 9 0
1,00,000	19,354 3 0
3,00,000	83,112 0 0
5,00,000	1,73,380 12 0
10,00,000	4,56,636 5 0
20,00,000	10,26,514 12 0
30,00,000	15,96,393 4 0

(b) Corporation Tax

The next important tax, viz., the Corporation Tax was levied at a flat rate of thirteen pies on the excess above Rs. 20,000 of the income of every company. Since the income of a person from shares has no relation to his other income, and since both these have no relation to the income of the company or companies in which he

holds shares, this tax also must be ignored. If the Corporation Tax recognized no exemption limit, and we ignored the benefit element in it, on the basis of the proportion of the income derived from corporations to the total income of any group, we could have calculated the burden of this tax like the U.S.A. studies.

### (c) Death Duties

Our probate duties partake little of the character of death duties in other foreign countries. Income is but a very minor factor in deciding their payment and their amount.<sup>1</sup> We have, therefore, to omit these duties.

### (d) Excise (Provincial and Central) and Customs' Duties Concept of Relating them to Income

In order that relating the Customs' and Excise duties to income may be more than a convenient fiction, the size of income of an individual must be of preponderant importance in deciding the amount and methods of expenditure.<sup>2</sup> All other factors like the source of income, the nature of income (precarious or secure, widely fluctuating or regular), the locality, and personal whims and tastes must be of secondary importance. It is, of course, not essential for this purpose that every person within the same income group must spend approximately equal sums on every taxed item. It often happens, that a person's lack of expenditure in one direction may be offset by his excess of spending in another. Where the system of commodity taxation is fairly widespread, and where taxes on most of the commodities are at equal rates, it is sufficient if the amounts of expenditure of persons within the same income group do not fluctuate widely. In the West, this condition is fairly well satisfied. The class standards of expenditure have become so ingrained there that a person having a certain income is bound to possess certain things, say a car, a library, a collection of pictures,

<sup>1</sup> For a fuller discussion, *supra* pp. 93-97.

<sup>2</sup> The division of taxpayers into non-income groups can partly help us in other cases.

etc., even though he may not enjoy or appreciate them.<sup>1</sup> These things have acquired the status of indispensable appendages to his income, as was the case with certain dresses, signs, and symbols in feudal times. In India, conditions are not yet advanced so far. Though with the impact of Western culture and with the growth of the large cities that it implies, caste barriers are breaking down, and the idea of living according to one's income is gaining ground, the process is far from complete even in large towns. Even in the lower urban classes where most of the expenditure is on absolute necessities, the moment there is any volition, the influence of the caste factor is at once seen. Their expenditure on drinks frequently varies with caste. In the case of upper income groups, the variations are greater. Personal whims and idiosyncracies occupy quite an important role in the amount spent and saved. It is not an unusual sight in Indian cities to see a person of lakhs, especially of the old generation, living in a slum, moving about in torn shirts and labouring like a coolie. While these show the need of using the calculations we arrive at with care and caution, sufficient progress in class patterns of living has been already made to make the average income group consumption figures more than a mere arithmetical average.

With regard to villages,<sup>2</sup> the position is still more unsatisfactory. Caste there is yet a force to be reckoned with. But even in villages it is becoming more and more usual for the sons of moneyed persons, to whatever caste they belong, to go to cities to acquire higher education. They bring with them to their homes the habits of class expenditure they have acquired when in cities. Thus, though not well developed, the class methods of expenditure are already in the making even in rural areas. There are backward villages, where this does not seem to hold good. But it must be remembered that this state of affairs continues, only because the incomes of the caste

1 See Professor Laski's "Dangers of Obedience."

2 Though we are treating rural incomes separately, we have taken up this discussion here, as it is more convenient.

members are not grossly unequal. If great inequalities were to develop within the caste, there is no doubt that the same phenomenon of class formation, as is apparent elsewhere, will make its appearance after a certain time lag. It is only where caste and income seldom come into conflict, that the caste standards of expenditure can persist.<sup>1</sup>

Locality is still a very important factor in deciding the amount of expenditure. A person in Bombay, to take an extreme case, has to spend far more on rent, and spends far more on his clothes than his colleague living elsewhere. A person's needs in Bombay are so many, that he seldom gets enough to satisfy them; in other smaller cities the problem of spending one's income—though it be very moderate judged by the standards prevalent in Bombay—would be insoluble.<sup>2</sup> In a country of the size of India, and with such a little developed transport system as hers, this is natural. But our inquiry has been restricted to British Gujarat only, where the uniformities are much greater, and sufficient to justify our concept.<sup>3</sup>

### Difficulties in Measurement

The fundamental difficulty in the process of relating commodity taxation to income being got over,<sup>4</sup> we can now pass on with a clear conscience to confront the great obstacles created by the complexity of the modern tariff. From the third quarter of the nineteenth century to the first quarter of the twentieth—the period with which the two British studies we have examined in detail were concerned—the tariff structure in U.K. was simple. The principle of *laissez faire* and free trade ruled supreme;

<sup>1</sup> It must further be remembered that our method of grouping rural population lessens this difficulty.

<sup>2</sup> The ways of living in different villages are not less diverse.

<sup>3</sup> The differentiation of incomes into urban and rural has dealt with the greatest locality influence—difference between urban and rural ways of living.

<sup>4</sup> Other minor difficulties, e.g., those revealed by the Bombay Labour Office Budgets that the middle classes spend more on rent than persons of wage earning class of the same income, have not been dealt with here.

there were no protective, and only a few preference duties; alternative and mixed duties were not yet in vogue; taxes on raw materials and machinery were looked down upon. Duties on imported goods tended to be simple and specific. A revolution has taken place within the tariff structure since then. The abandonment of *laissez faire* and the widespread prevalence of trade agreements have led to differential duties both for protective and preference purposes; taxes on raw materials and machinery occupy an important place; duties levied are often compound and alternative. Under these greatly changed conditions, precedent often fails to furnish us with a clear guide, and we have to work out a method from first principles.

The simplest case in our present tariff structure (i.e., structure as in the year 1938-39) is when a specific tax is levied on the entire amount of consumption goods at a uniform rate. Here, given the quantity consumed by a representative person of a certain income group, to find out the amount of tax he pays through consumption of that commodity is a simple arithmetical process.

A slightly more difficult case arises, when the duty levied is *ad valorem*, other circumstances remaining the same. The duty is levied on "real value;"<sup>1</sup> from family budgets, we can only know the amount spent in retail purchases. In order to ascertain the tax burden, we must derive the former from the latter. In the Customs' tariff schedules published annually, we get real values in case of some commodities. Where the commodity has only one standard quality, from this information an *ad valorem* tax can easily be reduced to a specific one. If however, the commodity has more varieties, and their prices are published, we must get the retail prices of these varieties from family budgets or from the market; work out the percentage differences between the two i.e. retail price

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1 The "real value" is defined as the "wholesale price less trade discount for which goods of the like kind and quality are sold or capable of being sold at the time and place of importation without any deduction except that of the amount of duties." Vakil and Munshi, Industrial Policy for India, p. 111.

and real values, and strike out an average. The task of ascertaining the rate of the tax on retail prices is easy. To find out the amount of duty paid by various groups from this and their expenditure on this particular commodity is simple. Usually none of these two methods is possible because no official valuations are available. Our task then becomes more difficult, and we are thrown back on merchants for both types of information. The traders, though very willing usually to mention retail prices, when they do not want to tell lies, prefer to maintain a shrewd silence on real values.<sup>1</sup> In some cases, even retail prices are a matter of individual bargaining e.g. in case of cars and radios. The truth can only be ascertained approximately in such cases.

A greater difficulty arises, when the duty is alternative. Both *ad valorem* and specific rates are laid down in such cases, and the higher rate is charged. Such duties, as we have already pointed out in Chapter VI, mean a higher rate of tax on the lower grades of quality,<sup>2</sup> and levy a greater burden on the consumers of these inferior varieties, who usually belong to the lower income groups. If it were possible to get the consumption of these lower varieties by each income group and the percentage tax on each variety, the problem could be dealt with satisfactorily. Even if it were possible to make a rough guess as to what income groups the consumers of inferior qualities belong (this usually is possible) and the number of persons within these groups, it would be possible to arrive at the extra burden thrown on each person earning less than a certain amount.<sup>3</sup> In the absence of these data, we must treat the duty as *ad valorem* only, remembering

<sup>1</sup> The War and the various controls have reinforced this natural reluctance.

<sup>2</sup> The word "lower" and "inferior" are used to connote those varieties of a commodity, on which the tax actually levied is specific.

<sup>3</sup> The extra amount of tax, that has been paid due to the tax being alternative, can be found out by subtracting the amount that would have been paid, if the duty were only *ad valorem*, from the tax now paid. Dividing this by the number of families using lower varieties will give the extra burden per family.

that really such duties mean higher burden on lower income groups.

A very similar case is of a compound duty being levied on a commodity as in the case of cigarettes. The tax can be reduced to an *ad valorem* basis by dividing the revenues brought in by the total value of the imported commodity.

The greatest difficulty with regard to the calculation of the tax burdens on consumption goods arises in case of differential duties. In theory, even here, the difficulty can be resolved. If it is possible to assign the consumption of the lower taxed and the higher taxed portions of the commodity to different income groups, the method is easy. The two parts of the commodity can be treated as two distinct commodities subject to different rates.<sup>1</sup> This, however, is seldom possible. Owing to the furious competition that usually prevails between varieties of the same commodity, and because in many cases differential duties are more the result of other than tax considerations and not infrequently even of chance, this simple process is not possible. The only possible method is therefore that adopted by the Colwyn Committee, i.e., taking the total amount of tax paid on the commodity in question and the total value of that commodity, dividing the one by the other, and treating the result as a uniform tax levied on the entire commodity. But here we have to face another difficulty peculiar to our country. In cases, where the differentiation is between home-produced and foreign goods, the figures of home-produced goods are rarely available. In such cases, while collecting family budgets, we tried to obtain separate figures for their consumption of foreign goods. Only in some cases, we were successful. In many cases, the family heads had no idea as to the division of their expenditure between foreign and home-produced goods respectively. The number of families able to give us these figures varied with different commo-

<sup>1</sup> We have adopted this method in case of Japanese and British cloth. In some other cases like patent medicines we have to resort to this course because of absence of home production figures.

dities. In case of those, where about 25 per cent of the total number were able to give some definite reply, we have proceeded on the assumption that the pattern of consumption was the same in remaining cases. Where, however, the number was smaller, this assumption was obviously unreasonable, and we had to proceed on other less satisfactory bases.

As we pass on from the realm of consumption goods to that of raw materials, machinery and intermediate business goods, our difficulties increase, and almost become insuperable. In all these cases, if reasonably accurate estimates are to be formed, it is necessary to ascertain the contribution of these commodities to the value of the final consumption goods which are fashioned out of them. This cannot be done. All, that is possible, is to roughly allocate these duties on the basis of the nature and use of the commodities produced out of the taxed items, bearing in mind the greater regressive effects that these duties have as compared with the same revenue-producing duties on consumption goods made out of them.

#### Detailed Consideration

Having considered the general method of allocating customs and excise duties among income groups, let us now pass on to a detailed consideration of the main taxed articles. To get at the consumption of these by various income groups, we issued a questionnaire, in which consumption goods yielding a revenue of more than Rs. 2 lakhs were included.<sup>1</sup> Since the reliability of the tax calculations depend on the representative character of the budgets, all possible attempts were made to give due representation to various localities, classes, and castes comprising the population.<sup>2</sup> We were able to obtain from the urban areas<sup>3</sup> of Gujarat about 750 budgets; rejecting 64 as unsatisfactory for our purpose, we had at our dis-

1 *Vide Appendix C.*

2 For a fuller account, see Appendix D.

3 All places, having a population of 5,000 or over, are considered as urban areas.

posal 686 budgets. The budgets covered incomes upto Rs. 12,000, after which the increase in commodity taxation become a very small part of the income, and, still more of the total tax burden. The income scales chosen for measuring the tax burden were Rs. 250, 500, 1000, 2000, 5000 and 10,000.<sup>1</sup> The various income groups were so chosen as to yield these incomes as averages, so that no adjustment should be needed. The groups selected were:—150-300; 301-600; 601-1200; 1201-2500; 2501-6000; and 6001-12000. On such varied items as our tax system embraces, no adjustment on account of family size was possible. But the fact that the average size of the family has not varied much in the lower income groups—the numbers of family members were 3.8, 4.0, 3.9 and 4.1 respectively in the first four groups—makes this failure of little significance.<sup>2</sup> The budgets were collected mainly in 1941—a war year. But Japan had not entered the war till our enquiry was complete; inflation and rise in prices had as yet not been witnessed. The consumption habits in that year might, therefore, be assumed to have been the same as in 1938-39.<sup>3</sup>

**Food Articles (i) Salt:** The first item, that we come across, is salt. The duty levied on it is specific; both imported and home-produced salt are taxed alike, at Re. 1-4-0 a Bengali maund.<sup>4</sup> The task of working out the duties paid by various income groups is, therefore, simple.

Income	Quantity of Salt consumed annually	Tax paid
Rs.	Seers	Rs. a. p.
250	36	0 9 0
500	44	0 11 0
1,000	50	0 12 6
2,000	52	0 13 0
5,000	52	0 13 0
10,000	52	0 13 0

<sup>1</sup> We could not take Rs. 10,000 and above group as in English studies because of the absence of income and consumption statistics.

<sup>2</sup> For greater details regarding family budgets, see Appendix E.

<sup>3</sup> This was obviously not true of the areas brought under the Prohibition scheme regarding their consumption of intoxicants. In these cases we asked the families about their 1938-39 consumption.

<sup>4</sup> In the calculations that follow, the rates of duty are taken from the (contd.)

(ii) **Potatoes:** A tax was levied only on imported potatoes—20 per cent on colonial produce, and 30 per cent on foreign products. But the quantity of potatoes imported from abroad bears a small proportion to that produced at home. The value of imported potatoes in 1938-39 amounted to only Rs. 36 lakhs compared with the Rs. 952 lakhs of home-produced potatoes,<sup>1</sup> i.e., about 3.8 per cent. This means that either the consumers of potatoes from abroad are a special class, or that the tax is not shifted to them. We have, therefore, decided to omit this duty from our consideration.

(iii) **Sugar:** On imported sugar, in the year 1938-39, a protective duty of Rs. 8-12-0 per cwt., was levied; on sugar produced in India except Khandsari and Palmyra, an excise duty of Rs. 2 had to be paid; Khandsari sugar was taxed at only 8 annas. The quantum of the imported sugar in 1938-39 was 32.7 thousand tons;<sup>2</sup> the quantity of sugar (except Khandsari) produced at home was 7.7 lakhs of tons; Khandsari sugar was produced in a small amount (19,000 cwt), and was consumed mostly in U.P. The rate of sugar duty per cwt. came to Rs. 2-4-6 per cwt. on all types of sugar, i.e., about 1 anna per 3 lbs.

The duties paid by various income groups are worked out below:—

Income	Quantity of Sugar consumed <sup>3</sup>		Tax Paid		
	Rs.	Lbs.	Rs.	a.	p.
250	60		1	4	0
500	84		1	12	0
1,000	144		3	0	0
2,000	170		3	8	9
5,000	180		3	12	0
10,000	213		4	7	0

Customs Tariff Schedules or Finance Acts, the amounts yielded by various duties and the value or quantity of goods imported from the "Sea-Borne Trade and Navigation Accounts" or from Governments' budgets. For the value of home-produced goods, the "Monthly Figures of Production of Certain Selected Industries in India" has been drawn upon. Other publications, when consulted, have been specifically referred to, unless obvious.

1 Report on the Marketing of Potatoes in India and Burma, p. 26.

2 The value of imported sugar varies widely from year to year. In 1937-38, only 2 percent of total sugar consumption was imported.

3 These figures of sugar consumption include sugar taken outside home through tea and coffee, but not otherwise. No figures for the percentage of sugar consumption omitted in this way are available, but seeing that the

(iv)—(vi) **Cloves, Nutmegs and Cocom:** The family expenditure both on cloves and nutmegs is too small to be taken into account. When a family consumes cocom, its expenses on it are large, but so few families in Gujarat use it that the average consumption is meagre.

(vii) **Betelnuts:**<sup>1</sup> On betelnuts imported from non-Empire countries, a duty of 45 per cent was levied; those from the Empire countries were taxed at 37½ per cent. The betelnuts produced at home were not taxed at all. The value of the imported betelnuts amounted to Rs. 196 lakhs in 1938-39; but we have no idea of the value of those produced at home.<sup>2</sup> We have, therefore, to devise some rough method to allocate the duty on foreign betelnuts which amounted to Rs. 77 lakhs in 1938-39. On the assumption that the consumption of betelnuts in British Gujarat is on the same basis as in the whole of India, and that in villages the betelnut consumption per family is only 1/3rd of that in cities, the duty per family in Urban Gujarat amounts to 4 annas-3 pies per head. Considering the consumption of various income groups, we assign the tax burden as under:—

Income. Rs.	Expenditure on Betelnuts. Rs. a. p.	Tax Paid. Rs. a. p.
250	1 9 0	0 4 0
500	1 11 0	0 4 3
1,000	1 14 0	0 4 6
2,000	2 8 0	0 6 0
5,000	2 9 0	0 6 0
10,000	2 12 0	0 7 0

(viii)—(xi) **Dried Fruits:** There was a differential duty levied on it—30 per cent on non-Empire products, 20 per cent on colonial products, and none on home products. The duty levied at the standard rate on foreign

total non-domestic sugar consumption for the Bombay Province was 13.8% of the total human sugar consumption, this omission is not important. Report on the Marketing of Sugar, Appendix XXXIV.

1 Both in case of betelnuts and cigarettes due to lack of statistics we have been forced to neglect the contribution of the Indian States' population to the customs' duties of British India.

2 Owing to the excise duty levied on betelnuts since April 1945, an estimate of production can be made now from the tax proceeds, but this is not reliable.

products yielded 23 times as much as the duty levied at the preferential rate,<sup>1</sup> so that we may take the rate of duty on all imported products at 30 per cent. We have no estimates of the production of dried fruits at home, but it is negligible. The item contains many sub-items and there are many varieties in each sub-item. It is not, therefore, possible to obtain the exact percentage difference between the "real value" given in the schedule and the retail price. But on inquiries made from various merchants, we put this roughly at 33 1/3 per cent. The duties paid by various income groups on these assumptions are shown below:

Income.	Expenses on Dried Fruits.	Tax Paid.
Rs.	Rs. a. p.	Rs. a. p.
250	0 0 0	0 0 0
500	1 0 0	0 2 0
1,000	2 3 0	0 6 0
2,000	4 0 0	0 11 0
5,000	5 0 0	0 13 0
10,000	7 10 0	1 5 0

(xii) **Bidis:** This item was only put to demarcate the expenditure on bidis, which are a non-taxed item, and the expense on cigars and cigarettes which are taxed in part.

(xiii) **Cigarettes:** The duty levied on cigarettes was compound, the rate being 25 per cent *ad valorem* plus Rs. 8-2-0 per 100 or Rs. 3-4-0 per lb., whichever was higher; no duty was levied on home-produced cigarettes, but a large part of them is produced from manufactured tobacco imported from abroad. The cigarettes duty, together with that on manufactured tobacco yielded Rs. 151 lakhs in 1938-39. Because of the varying proportions of foreign tobacco in Indian cigarettes and absence of precise information regarding their consumption, the duty has, to be allocated on general considerations. Ac-

<sup>1</sup> The item No. 8, under which the Customs returns are given, is wider. It embraces all fruits, fresh, dried, salted or preserved, not otherwise specified. We have assumed that the ratio relationship between the yield at standard rates and that at preferential rates with regard to dried fruits is the same as in case of the wider item.

cording to our inquiry, the cigarette expenses of the various income groups were as under:

Income.	Expenditure on Cigarettes.
Rs.	Rs. a. p.
250	0 0 0
500	0 0 0
1,000	0 0 0
2,000	8 4 0
5,000	14 8 0
10,000	20 2 0

Allowing for the facts that the higher classes spend proportionately more on consumption of foreign cigarettes, and that the cigarette duty in its present form means a relatively lower burden on higher groups, we may reasonably assume that the duty paid by the group Rs. 2501-6000 was twice that paid by the Rs. 1201-2500 group, and that paid by the Rs. 6001-12000 group thrice. On the assumption that the proportion of contribution among various income groups in British India was the same as that among British Gujarat groups, the duties paid by British India income groups are worked out below.<sup>1</sup> The contribution by British Gujarat income groups has been taken as one-third of that of British India as a whole.<sup>2</sup>

Income.	Tax Paid in Urban British India	Tax Paid in Urban Gujarat
Rs.	Rs. n. p.	Rs. n. p.
250	0 0 0	0 0 0
500	0 0 0	0 0 0
1,000	0 0 0	0 0 0
2,000	17 8 0	5 13 3
5,000	35 0 0	11 10 9
10,000	52 8 0	17 8 0

(xiv) Cigars: Very few persons in Gujarat smoke cigars, so that this item need not be included.

1 The number of members within the two higher groups has been worked out from the Income Tax Report, 1938-39. The number of persons with incomes below Rs. 2,000 (not being liable to any income tax) in 1938-39 could not be had from the Report. It was assumed that the same number of persons was within this group as in the year 1935-36, the last year when the exemption level was Rs. 1,000. Rural areas have been assumed to contribute nothing to cigarette taxation.

2 According to the Report on the Marketing of Tobacco in India and Burma, the per capita tobacco consumption of Bombay Province in 1934-35 by way of consumption of cigarettes, cigars and cheroots was 0.132 compared with 0.312 throughout India. In Baroda, the per capita consumption was 0.111 (App XXVIII p. 443)

(xv) **Tobacco:** This item was only included for demarcation purposes.<sup>1</sup>

**Taxes on Drinks—(i), (ii) and (vii)—(x): Toddy, Country Liquor, Opium, Bhang, Ganja and Charas:** The correct figures for consumption of these items are very difficult to obtain. Even in a country like England, where drinking is a social custom, its consumption by different income groups could not be ascertained, for such an inquiry was keenly resented<sup>2</sup> In India, drinking is looked upon as a crime against religion and society, so that a drunkard dare hardly confess even to himself the extent of his drunkenness. We have, therefore, been forced to adopt roundabout methods for determining the duties paid by various income groups in each of these cases.<sup>3</sup> The common assumptions taken in all these cases have been that (a) families with incomes of more than Rs. 1,200 do not contribute anything by way of excise taxation. In our inquiry, we came across only two families earning more than Rs. 1,200 which reported expenditure on these items. While in case of some families this failure may be due to the natural greater reluctance of higher classes to confess to a use of these items, the reason in case of most must have been their actual lack of expenditure on them; (b) that representative persons of the income groups Rs. 301-600 and Rs. 601-1,200 pay twice the tax paid by similar persons of 150-300 income group. The actual expenditure as in our budgets on toddy, country liquor, and foreign liquor (Indian) is Rs. 2-6-0 for Rs. 250 income, Rs. 5-12 for Rs. 500 group, and Rs. 4-8-0 for Rs. 1000 in-

1 The taxes levied under the District Tobacco Act on traders yielded 2.6 lakhs in 1938-39 in the Bombay Province. But the license fees levied under the Act have no connection with the sales ; their incidence has therefore to be ignored.

2 Journal of the Royal Statistical Society (1919), p. 168 and Report of the Committee on National Debt and Taxation, para 241.

3 In the Labour Office Budgets in the Bombay Province, doubts regarding the reliability of their figures of liquor consumption are repeatedly expressed. The fact, that we could not for obvious reasons, adopt the selected random sampling method in collection of our budgets, added a further element of inaccuracy in case of figures regarding a commodity like this, whose consumption widely fluctuated. Any direct use of the figures obtained was, therefore, out of question.

come.<sup>1</sup> For opium, bhang, ganja and charas, the expenditure is Rs. 1-6-0, Rs. 2-8-0 and Rs. 2-6-0 respectively. In case of higher income groups, the reluctance to confess drink is higher, so that the actual expenditure made by the higher groups must have been larger; (c) that the total number of persons in the second and third groups combined was about the same as that in the first.

**Country Spirit:** The total consumption of country spirit in Gujarat urban areas was 82,736 gallons in 1938-39.<sup>2</sup> We have no figures of the rate of duty levied on this; but assuming that it was the same as that on the country spirit consumption in large towns of Gujarat the duty came to Rs. 13.95 per gallon.<sup>3</sup> The tax per head came to Rs. 1-9-6, and per family<sup>4</sup> to Rs. 5-11-9. Allowing for the fact that the urban consumption in the Excise Report is that of places having a population of more than 10,000, whereas in our calculations all places with a population of 5,000 and over are considered as cities, and that the urban consumption in country liquor is much greater than rural consumption, the duty may well be placed at Rs. 4-0-0 per urban family.

**Toddy:** No figures of toddy consumption in urban Gujarat are available. But, the total consumption in the whole of British Gujarat was 39,30,000 gallons in 1938-39, and the total revenue Rs. 14,16,000.<sup>5</sup> Assuming that the *per capita* village consumption in Gujarat is 1/3rd that in cities, the duty works at Re. 0-14-6 per citizen i.e. Rs. 3-4-3 per family in the city.

1 As some of the areas, we visited, were prohibition areas, we had to rely on persons' memory to get their past consumption.

2 Worked out from Col. 5 of Appendix A—Report on the Administration of the Excise Department of the Province of Bombay, 1938-39, pp. 28-29.

3 From Appendix A(a), *Ibid.*, p. 30.

4 A family in Urban Gujarat according to the 1931 census consists of 3.6 persons.

5 Col. 13, Appendix A, p. 33, and Col. 10, Imperial Returns, I, p. 53. It must be remembered in this connection that the excise duties on the same type of liquor or toddy widely vary with localities (Imperial Table IV of the Excise Report). The taxes therefore paid by persons earning the same income and consuming the same intoxicating liquor will greatly differ. We have ignored these differences.

**Opium, Bhang, Ganja and Charas:** The total duty from all these sources amounts to Rs. 569,000.<sup>1</sup> On the same assumption regarding the ratio of urban to rural consumption as in case of toddy, this works out at an average of Re. 0-5-9 per citizen, i.e., Rs. 1-4-9 per urban family.

The total duties from country spirits, etc., work out as under:—

Income	Tax on Country Spirit	Tax on Toddy and Fermented Liquor.	Tax on Opium, Bhang, Ganga & Charas.	Total Tax
Rs.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.
250	2 10 9	2 2 9	0 13 9	5 11 3
500	5 5 3	4 5 9	1 11 9	11 6 9
1,000	5 5 3	4 5 9	1 11 9	11 6 9
2,000	0 0 0	0 0 0	0 0 0	0 0 0
5,000	0 0 0	0 0 0	0 0 0	0 0 0
10,000	0 0 0	0 0 0	0 0 0	0 0 0

**(iii)—(vi) Foreign Liquor (not Indian made), Ale, Beer, Spirits, Wine, etc.:** The total Customs' duty on foreign liquor amounted in the year 1938-39 to 179 lakhs.<sup>2</sup> According to our inquiry, the consumption of foreign liquors begins at about Rs. 1,200 income. The income group Rs. 2,501—6,000 spent on foreign liquor about four times, the Rs. 1,201—2,500 group (Rs. 40-12-0 compared with Rs. 10-4-0), and Rs. 6,001—12,000 about ten times (Rs. 105). Because of the greater duties that the higher varieties of liquors consumed by the richer classes pay, it might be assumed that the group Rs. 2,501—6,000 paid six times the liquor tax paid by Rs. 1,201—2,500 group, and Rs. 6,001—12,000 group three times that paid by Rs. 2,501—6,000. On assumption that the various income groups in British India contribute in about the same proportion as those in Gujarat, and that Gujarat groups contribute about 1/4th of that paid by their Indian compeers,<sup>3</sup> the duties are worked out below:—

<sup>1</sup> *Ibid*, Imperial Returns I, Cols. 28 and 40, pp. 57 and 59.

<sup>2</sup> This represents the total of duties from items 22, 22(1), 22(2), 22(3), 22(4) and 22(5), except 22(5) (b) and 22(5) (c), in the Customs Returns.

<sup>3</sup> The villages are assumed not to consume any foreign liquor at all.

Income.	Tax Paid in India.	Tax Paid in Gujarat.
Rs.	Rs. a. p.	Rs. a. p.
250	0 0 0	0 0 0
500	0 0 0	0 0 0
1,000	0 0 0	0 0 0
2,000	6 9 0	1 10 3
5,000	39 6 0	9 13 6
10,000	118 2 0	29 8 6

In addition to these taxes, a license fee of Rs. 48 thousand was realized from foreign liquor in Gujarat in 1938-39.<sup>1</sup> The number of income tax assessees in Gujarat in 1938-39 was 20,465. Looking to the small amount of the tax as well as the lack of information regarding the further classification of these taxpayers, the tax had better been ignored.

**(xi) and (xii) Prepared Tea and Coffee:** These items were included to calculate the sugar consumption of the various income groups through hotel-tea and coffee. The results have already been included in sugar consumption.

**(xiii) Patent Medicines:** These were taxed at 30 per cent when coming from foreign countries, and at 20 per cent when belonging to Empire countries. The values of both were about the same, so that on the whole quantity of foreign patent medicines consumed in India, the tax came to about 25 per cent. No figures of the value of patent medicines produced in India are available, so that any method of working out the duty from total patent medicines used by various income groups is out of question. Fortunately, in case of 267 budgets, we could obtain the consumption of foreign patent medicines separately. Patent medicines present a bewildering variety, and profits on them widely vary; but the percentage difference between the real value and retail prices as a whole might well be placed at 33-1/3. The burdens on various income groups on these assumptions are as under:

<sup>1</sup> Col. 16, Imperial Returns (1), Excise Report.

Income. Rs.	Expenditure on Foreign Patent Medicines. Rs. a. p.	Tax Paid. Rs. a. p.
	0 0 0	0 0 0
250	0 0 0	0 0 0
500	1 0 0	0 2 6
1,000	3 0 0	0 7 3
2,000	8 0 0	1 3 3
5,000	10 0 0	1 8 0
10,000	10 0 0	1 8 0

**Taxes on Fuel and Light—(i) Kerosene:** On home-produced kerosene, there was an excise duty of 2 annas 9½ pies per Imperial gallon; on kerosene imported from Burma a duty at the same rate was levied; but on that imported from elsewhere a duty of 3 annas 9 pies per gallon was levied. The Indian consumption of oil produced at home and of that imported from Burma amounted to 152.7 million gallons; kerosene imported from other places was 68 millions. The rate of the duty on the entire kerosene consumption came to 3 annas 1 pie per gallon. The taxes paid by various groups are, therefore, as under:—

Income. Rs.	Kerosene Consumption. Gallons.	Tax Paid. Rs. a. p.
250	6	1 2 6
500	7	1 5 6
1,000	9½	1 13 3
2,000	13	2 8 0
5,000	14	2 11 3
10,000	18	3 7 6

**(ii) Methylated Spirit:** A tax of 9-3/8 per cent *ad valorem* was levied on foreign denatured spirit. In addition, a small fee had to be paid for obtaining a license for selling spirits. However the expenditure on this item is too small to be taken into account.

**(iii) Matches:** On matches produced in India, an excise duty, varying with the number of sticks the boxes on an average contain, was levied. If the box contained 40 matches or less, a duty of Re. 1 per gross of boxes had to be paid; if the box contained from 41 to 60 matches a tax of Re. 1-8-0 had to be paid, and for those containing 61 to 80, Rs. 2 had to be given. On imported matches, the duties were Rs. 1-10-0, 2-7-0 and 3-4-0 respectively. Assuming that the average match box contained the maximum num-

ber of matches allowed at the rate charged, the total number of imported match boxes reduced to terms of those containing 40 matches amounted to 10 lakhs of grosses. The Indian production came to 228 lakhs of grosses. The total Indian consumption in terms of 40 sticks match-boxes was, thus, 238 lakhs of grosses. The total tax from matches amounted to Rs. 218 lakhs. The rate of the duty, thus, came to 15 annas per gross of boxes containing 40 matches on an average.

The burden of the match borne by different groups is shown below:

Income. Rs.	Consumption of Match Boxes of 40 matches. Gross. Dozens.		Tax. Rs. a. p		
250	1	3	1	2	9
500	1	6	1	6	6
1,000	2	0	1	14	0
2,000	1	8	1	9	0
5,000	1	9	1	10	3
10,000	1	9	1	10	3

(iv)—(v) Glass and Metal Lamps: The expenditure on these is too small to be taken into account.<sup>1</sup>

(vi) Stoves: The duty on it yielded less than Rs. 2, lakhs in 1938-39, so that this item had better been omitted.

(vii) Gas Mantels: The expenditure on this item is negligible with most of the families, so that the tax on it had better be ignored.

(viii) Glass Globes and Chimneys: The duty on them yielded only 50,000 rupees. We had, therefore, better drop it.

(ix) Electric Lighting Bulbs: The tax yielded about 13 lakhs of rupees in 1938-39, but most of it was obtained from persons in very big cities. The expenditure of Gujarati families on this item is small, and the duty paid thereby insignificant.

Articles of Wear—(i) Glass Bangles: A protective duty of 50 per cent was levied on foreign glass bangles;

<sup>1</sup> Whenever the expenditure on any item has been such, that the tax on it will not amount to more than one anna on the income of Rs. 250, two annas on Rs. 500 income, and so on, the expenditure has been called too small.

the home-produced bangles were not taxed. The imports of bangles were valued at Rs. 24 lakhs for 1938-39; the value of home-produced bangles for 1938-39 is not available. But the Tariff Board appointed to inquire into the case for protection of glass industry made a rough estimate of home production in 1929-30. On the assumption that the total value of glass bangles consumed in India has remained the same i.e. that the increase in home production has been equal to the decrease in foreign imports, the bangle production in 1938-39 may be put at 176 lakhs of rupees i.e. 7-1/3 times the value of imported bangles. Thus, less than 1/8th of the expenditure of bangles is incurred on foreign bangles. The family expenditure on foreign bangles worked out in this method is too small to be taken into account.

(ii) **Celluloid Bangles:** The family expenditure is so small that the tax paid through their consumption is inconsiderable.

(iii) **Glass Beads and False Pearls:** The case with these is the same as with celluloid bangles.

(iv) **Watches and Clocks:** The duty on imported watches and clocks was 50 per cent. Almost the whole of these used in India are imported, so that the duty on all the watches and clocks may be taken at 50 per cent. The wide variety of these and the different commissions given make any calculation of the difference percentage hard, but it may be safely placed at 25 per cent.

The taxes paid through expenditure on watches and clocks by various income groups are given below:

Income.	Expenditure on Watches and Clocks.	Tax Paid.
Rs.	Rs. a. p.	Rs. a. p.
250	0 0 0	0 0 0
500	0 9 3	0 2 6
1,000	1 14 0	0 8 0
2,000	4 0 0	1 1 0
5,000	7 3 0	1 14 0
10,000	12 2 0	3 3 9

(v) **Buttons:** The expenditure on metallised buttons is very small.

**Vessels and Other Things—(i) Vessels of all Metals:** Though the family expenditure on the items is big, most of the vessels are made from home-produced metals only. The only metal imported in bulk was unwrought copper, and even this was only 1/6th of the copper found in India. Even when the metal is imported, the vessels are wrought here, so that the duty bears a very small proportion to vessel expenditure. It should, therefore, be ignored.

**(ii)—(iv) Porcelain, Cutlery, Glass Vessels, etc.:** The duty on these, when imported from abroad, was 25 per cent; when produced at home, they had to pay no duty. We have no estimates of the home production of these articles. As in other such cases, our best efforts could not succeed in getting satisfactory answers to consumption of the imported parts of these items from a sufficiently large number. We have, therefore, to rely on forming rough estimates of their consumption for the various income groups from the figures we obtained in a very few cases viz. 84 budgets. Since similar difficulties confronted us in case of blades, ink and fountain pen, toilet, brush, pencil, etc., and since all these were taxed at 25 per cent, we take all of them together.

#### Expenditure of Various Income Groups

Item	Income			Scales		
	Rs. 250	Rs. 500	Rs. 1,000	Rs. 2,000	Rs. 5,000	Rs. 10,000
1. Porcelain Vessels	0 0 0	0 2 0	0 4 0	0 8 0	0 12 0	0 12 0
2. Cutlery	0 4 0	0 10 0	0 12 0	0 12 0	1 0 0	1 0 0
3. Glass Vessels	0 0 0	0 4 0	0 8 0	0 12 0	1 0 0	1 8 0
4. Toilet	0 0 0	0 0 0	0 4 0	0 8 0	1 8 0	3 8 0
5. Brush	0 0 0	0 0 0	0 0 0	0 6 0	0 8 0	0 8 0
6. Pencil, etc.	0 0 0	0 0 0	0 0 0	0 6 0	0 8 0	0 8 0
7. Blades, etc.	0 0 0	0 4 0	0 8 0	1 0 0	1 0 0	1 4 0
8. Ink, pen, etc.	0 0 0	0 0 0	0 8 0	0 12 0	1 4 0	1 8 0
	0 4 0	1 4 0	3 0 0	5 0 0	7 8 0	10 8 0

On this group of miscellaneous articles, a percentage difference of  $33\frac{1}{3}$  is assumed. The tax burden on different income groups works out as under:—

Income.	Expenditure.	Duty Paid.
Rs.	Rs. a. p.	Rs. a. p.
250	0 4 0	0 0 6
500	1 4 0	0 3 0
1,000	3 0 0	0 7 3
2,000	5 0 0	0 12 0
5,000	7 8 0	1 2 0
10,000	10 8 0	1 9 3

**Foreign Games:** The same difficulty exists here as with regard to the items discussed above. We have only taken it separately, because the tax on it is 50 per cent.

Income.	Expenditure <sup>1</sup>	Tax Paid.
Rs.	Rs. a. p.	Rs. a. p.
250	0 4 0	0 1 0
500	1 0 0	0 4 0
1,000	3 0 0	0 12 0
2,000	5 0 0	1 4 0
5,000	10 0 0	2 8 0
10,000	15 0 0	3 12 0

**Miscellaneous Things—(i)—(v) and (vii)—Soap, Polish, Artificial Leather, etc:** Foreign soap polish and artificial leather are used by a very limited number in Gujarat. We had, therefore, better omit them.

**(viii) Musical Instruments:** The important foreign musical instruments used in Gujarat are the gramophone and the radio. The radio is treated separately afterwards; so that only the gramophone concerns us here. The expenditure on gramophones becomes of any consequence only in the income group above Rs. 1,200; even in that group, the annual expense is less than Rs. 2. The rate of duty is only 50 per cent, so that the tax on Rs. 1,000 income will work out at less than 8 annas. This item, therefore, had better be ignored.

**(ix) Painting and other Materials:** In Gujarat, a few among the rich classes take to this. It is a matter of individual fancy. We, therefore, do not propose to take this into account.

**(x) Petrol:** To allocate this is a simple task, for a specific duty per gallon is levied on it. The tax was 10

<sup>1</sup> Based on 92 budgets.

annas in 1938-39, but out of this 2½ annas were credited to the Road Fund; so that we should calculate the duty only on the basis of 7½ annas per gallon.

Income.	Petrol Consumption.	Tax Paid.
Rs.	Gallons.	Rs. a. p.
250	..	0 0 0
500	..	0 0 0
1,000	..	0 0 0
2,000	..	0 0 0
5,000	86	16 14 0
10,000	180	84 6 0

**Clothes—(i) Cotton Clothes:** A duty of 50 per cent was levied on Japanese cloth, and of 15 per cent on British cloth generally. The figures of Indian production are available, but different income groups consume these three types of clothes in varying proportions. We think it better to proceed on the expenditure on Japanese and British clothes that we could get in case of some families—325 in case of Japanese cloth and 343 in case of British cloth. We have taken the percentage difference at 25 per cent.

Income.	Expenses on Japanese Cloth.	Expenses on British Cloth.	Tax on Japanese Cloth.	Tax on British Cloth.	Total Tax on Cotton Cloth.
Rs.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.
250	0 0 0	0 0 0	0 0 0	0 0 0	0 0 0
500	2 0 0	0 0 0	0 8 6	0 0 0	0 8 6
1,000	4 0 0	2 0 0	1 1 0	0 3 3	1 4 3
2,000	6 0 0	5 0 0	1 9 6	0 8 3	2 1 9
5,000	10 0 0	15 0 0	2 10 9	1 9 0	4 3 9
10,000	15 0 0	20 0 0	4 0 0	2 1 6	6 1 6

**(ii)—(iii)—Silk and Artificial Silk:** A duty of .50 per cent on the whole was levied on silk and artificial silk imported from abroad. According to the Tariff Board Report appointed to inquire into the case for protection of silk industry, 45-50 per cent of the total silk consumption was produced at home.<sup>1</sup> Assuming that the same proportion subsists to-day, and a 25 per cent difference between wholesale and retail prices, the duties are worked out as under:—

<sup>1</sup> Report on the Sericultural Industry, 1933, para 134.

Income.	Expenses on Silk and Artificial Silk.	Duty Paid
Rs.	Rs. a. p.	Rs. a. p.
500	2 4 0	0 5 0
1,000	7 0 0	0 15 0
2,000	14 0 0	1 13 9
5,000	19 0 0	2 8 6
10,000	37 0 0	4 14 9

**Woollen Clothes and Shoes:** Most of the woollen clothes and shoes used in Gujarat are home-produced. Only in rare cases, foreign shoes or imported woollen clothes are used.

**Umbrellas:** Only a part of the umbrellas sold is imported from abroad. Considering the expenditure on umbrellas by various groups in Gujarat, the duty paid must be small and not worthy of any attention.

**Overcoats:** They are seldom used in Gujarat and foreign overcoats are almost a sight. This item is, therefore, better ignored.

**Paper and Stationery:** Almost all the Indian paper ordinarily used for writing is produced at home. The higher quality foreign paper for writing is seldom resorted to in Gujarat, so that no calculations are necessary on this account.

**Radios:** A tax of 50 per cent was levied on radios imported from abroad. Almost all the radios are imported from abroad. The great bargaining usually resorted to in radio purchases makes it hard to calculate the difference between the f.o.b. price and the retail price; but a 33 1/3 per cent margin is not wide of the mark.

Income.	Expenditure.	Tax Paid.
Rs.	Rs. a. p.	Rs. a. p.
250	0 0 0	0 0 0
250	0 0 0	0 0 0
500	0 0 0	0 0 0
1,000	0 0 0	0 0 0
2,000	4 0 0	1 0 0
5,000	12 0 0	3 0 0
10,000	15 0 0	3 12 0

**Fans, Batteries, Electric Wires, Meters, Motor Cycles and Refrigerators:** The expenditure on each of these

items is so small and accidental that it had better be ignored.

**Motor Cars:** A duty of 37½ per cent was levied on cars imported from non-Empire countries; Empire cars had to pay a duty only of 30 per cent. The former yielded 57 lakhs of rupees in 1938-39, while the latter 30 lakhs, so that the duty on the whole worked out at a rate of 35 per cent. The prices of cars are usually a matter of much individual bargaining, but a 25 per cent margin is usual.

Income.	Expenditure.	Tax Paid.
Rs.	Rs. a. p.	Rs. a. p.
250	0 0 0	0 0 0
500	0 0 0	0 0 0
1,000	0 0 0	0 0 0
2,000	0 0 0	0 0 0
5,000	96 0 0	19 14 6
10,000	250 0 0	51 18 0

**Cycles:** Imported cycles were taxed at 30 per cent when from non-Empire countries, and at 20 per cent when from Empire countries. The duty on the whole, came to 22 per cent. Worked out on this basis, the duty amounts to less than two annas for Rs. 500 income scale, and so on; it had, therefore, better be ignored.

**Raw Materials and Machinery:** It is hard to allocate definitely these duties, which, according to Messrs. Gregory's and Natu's calculations, amounted to Rs. 17,68 lakhs in 1937-38, when the Customs' duties on consumption goods and the Central Excises amounted to Rs. 42,86 lakhs (2:5 proportion). The 1938-39 figures for the former are not available. Assuming that (a) the same proportion was retained between them and Central duties on consumption goods; and that (b) since the incidence of these duties must be somewhere between those of the Provincial and Central excises on the one hand and of duties on luxuries on the other, each income group contributed to them in the same proportion as to customs and excises (excepting duties on liquor), the burden works as follows:—

Income.	Customs Duty and Excise Duty on Consumption Goods (excepting toddy, etc.)	Tax Paid on Raw Materials and Machinery.
Rs.	Rs. a. p.	Rs. a. p.
250	4 7 9	1 12 0
500	7 3 3	2 14 0
1,000	12 8 0	5 0 0
2,000	27 7 6	10 15 9
5,000	81 3 9	32 8 0
10,000	199 6 9	79 12 3

### Total Customs and Excise Duties

The total Customs and Excise Duties paid by various incomes work out as follows:—<sup>1</sup>

Income.	Total Customs and Excise Duties.	Percentage of Income Paid.
Rs.	Rs. a. p.	
250	11 15 9	4.8
500	21 8 6	4.3
1,000	28 14 9	2.9
2,000	36 0 0	1.8
5,000	115 6 6	2.3 <sup>2</sup>
10,000	296 7 6	3.0 <sup>2</sup>

Since we have assumed that after Rs. 10,000 income the Customs' and Excise Duties paid do not increase, the percentage paid will go on falling in proportion to the rise in income.

### (e) Electricity Tax

The tax was levied in most of the cities at one anna a unit, but also at  $\frac{3}{4}$ th of an anna in some places. This however presented no difficulty as the consumers could themselves tell the tax they paid.

The taxes for various incomes are given below:—

Income.	Electricity Tax.
Rs.	Rs. a. p.
250	0 5 0
500	1 0 0
1,000	1 8 0
2,000	3 0 0
5,000	6 12 0
10,000	11 9 0

<sup>1</sup> For a fuller table, *vide* Appendix F.

<sup>2</sup> The slight rise in percentage after the Rs. 2,000 income group is due to luxury taxation—that on foreign liquors, cars and petrol.

### (f) Entertainment Taxes

The tax, while fairly simple, is by bracket system; and tickets not exceeding four annas were exempted from tax. The tax has, therefore to be worked out on rough assumptions.

Income. Rs.	Expenses on Entertainments.			Tax Paid. Rs. a. p.
	Rs.	a.	p.	
250	1	2	0	0 0 0
500	2	11	0	0 0 0
1,000	5	4	0	0 4 0
2,000	12	0	0	1 8 0
5,000	20	0	0	3 0 0
10,000	32	0	0	5 0 0

### (g) Stamps

(i) Non-Judicial: These duties yielded 77 lakhs of rupees in 1938-39 in the Bombay Province. But as we have seen, their incidence is so uncertain, and their burden on persons within the same income group so different that it is not possible to allocate them. Moreover, we have no detailed information of the proceeds from stamps on different kinds of transactions. Since, as we have seen, the stamp duties are in some cases *ad valorem*, in some cases flat, and sometimes a mixture of both, and they partake of different characters,—sometimes a business tax, sometimes a tax on property transactions, and at times even a fee paid for a privilege,—there is no possibility of even apportioning them very roughly.

(ii) Judicial: As we have seen in Chapter VIII, it is not possible with the present data to say whether and to what extent the proceeds from judicial stamps contain a tax element. We have, therefore, to ignore these duties.

### (h) Registration Fees

*A priori*, they seem to be not exceeding the value of benefit conferred. They are, therefore, not taxes at all.

### (i) Motor Vehicles Taxation

While the primary purpose of this Act is the regulation of vehicles, in recent years the tax has also brought

in handsome revenues. In the year 1938-39 the tax yielded Rs. 41,54,000 in Bombay Presidency. Out of this sum Rs. 18,63,000 were paid as compensation to local bodies, and Rs. 1,05,000 were credited to Provincial Road Fund, so that a net sum of Rs. 21,86,000 remained to the Provincial Government as tax proceeds. The main rates of taxes for private cars under the Bombay Vehicles Taxation Act are as follows:—

	Maximum Annual Rate of Tax
For Vehicles solely fitted with pneu- matic tyres.	For other Vehicles.

(a) Vehicles not exceeding 15 cwt. in weight, unladen .. .. ..	Rs. 40	50% in addition.
(b) Vehicles exceeding 15 cwt. but not exceeding 30 cwt. in weight, unladen .. .. ..	Rs. 60	" "
(c) Vehicles exceeding 30 cwt. but not exceeding 45 cwt. in weight, unladen .. .. ..	Rs. 80	" "
(d) Vehicles exceeding 45 cwt. in weight, unladen .. .. .. ..	Rs. 110	" "

Car-owners could easily say the amount of Vehicle tax that they paid. Half of this has been taken as tax burden, as 50 per cent of the tax proceeds go either to local bodies or for road development; the indirect burden on consumers through this tax has been neglected.

Income. Rs.	Tax Paid. Rs. a. p.
250	0 0 0
500	0 0 0
1,000	0 0 0
2,000	0 0 0
5,000	8 0 0
10,000	25 0 0

#### (j) Proceeds from Commercial Departments

We agree with Sir Herbert Samuel in general that the net revenue from a commercial department should be considered as a tax on the services rendered by that department. However, in case of forests and irrigation, we have already indicated our disagreement, as the former render a competitive service, and the latter confer a measurable benefit which the prices charged did not ex-

ceed. Since the commercialization of the Post and Telegraph Accounts, no surplus accrued to General Revenues from this Department till 1939-40. The only department, therefore, that did pay a tax to the Government, was the Railways which yielded 137 lakhs of rupees in 1938-39. But so many different services are rendered by railways, and the rates are so regulated, that it is not possible to apportion the tax.

### Total Burden on Urban Income Groups

The total tax burden on various urban income groups is worked out in Appendix F. For sake of convenience it is summarized here.

Income.	Tax Burden Borne	Percent to Income.
Rs.	Rs. a. p.	
250	12 4 9	4.9
500	22 8 6	4.5
1,000	30 10 9	3.1
2,000	41 8 0 (	2.1 (2)
5,000	303 6 6 (	6.1 (5.0)
10,000	846 12 6 (	8.5 (8.9)
15,000	1,354 9 6 (	9 (10.1)
30,000	3,555 1 6 (	11.9 (13.9)
50,000	8,406 9 6 (	16.8 (19)
1,00,000	19,602 3 6 (	19.7 (26.4)
3,00,000	83,450 0 6 (	27.8 (37.4)
5,00,000	1,73,727 12 6 (	34.7 (43.1)
10,00,000	4,56,974 5 6 (	45.7 (51.2)
20,00,000	10,26,852 1 6 (	51.3 (55.8)
30,00,000	15,90,731 4 6 (	58.2 (56.7)

### B. Rural Incomes

So far, we have been concerned with assessing the tax burdens on the various income groups in the cities. Now, we shall pass on to consider the burden in the villages.

Our original idea was to deal with village groups in the same way as with those in the city i.e. to ascertain from them their income, their expenditure on taxed items, their payments of direct taxes, and proceed on the aver-

1 The figures in brackets represent the calculations made on the basis of 1939-40 income and super tax rates. Though they were not applicable in 1938-39, and are technically outside our scope, they are a part of peace-time taxation and will stay after the war.

age plan. But after careful investigation we found that such a procedure was out of question. Most of the village families we visited were in no position to answer those questions with anything approaching that clarity and precision which we witnessed even in the lowest income groups in cities. Most of them had not a rough idea even as to their own income. Some of them laughed at the naive idea of an urban man, who could think that even those, who hardly had enough to eat twice, had an income. Only by a series of questions—in the case of cultivators regarding crops grown on their field, their price in the nearest bazaar, the costs of cultivation, etc., and in case of landless labourers or artisans by other appropriate questions some rough idea of their incomes could be arrived at. To know their expenditure was even more difficult. It required heroic efforts on their part to estimate their expenses even on the main items like food, clothing, etc.; as to the expenditure in detail that we wanted, they often shook their heads. It was only by leading questions that any reply could be elicited from them. In our village tour we were able to collect about 250 budgets, and our statements are based on their averages.<sup>1</sup> But this only means that we visited 250 persons in villages to correct, check, and make more vivid the impression we obtained from the leading villagers regarding their income and expenditure habits, and our calculations are based on these impressions. The results, therefore, though the best possible under the circumstances, must be interpreted with due caution.

For the purpose of measuring the tax burdens, it is convenient to divide the rural population into four broad classes:—(a) Landless Labourers, (b) Artisans, (c) Land-owners and (d) Traders.

#### (a) Landless Labourer

The payment in kind, that prevails in the case of a large number of them who are bound down to particular landowners, and the uncertainty of work in case of others.

<sup>1</sup> For fuller details, see Appendix D.

combined with the widely different wages prevailing in different villages make any estimate of their average income rather unreal. Our budgets give an average of Rs. 150 a year per family. The village labourer spends only on a few of the items in our questionnaire; salt, sugar, kerosene, matches, and toddy and other intoxicating drugs are the only taxed items he uses. The tax he pays by consumption of these items is calculated below:—<sup>1</sup>

Item.	Quantity Consumed	Tax Paid Rs. a. p.
1. Salt .. .. .. .. .. 30 seers.	0 7 6	
2. Sugar .. .. .. .. .. 20 seers.	0 6 0	
3. Country Spirit, toddy, <sup>2</sup> ganja, bhang, opium, etc. .. .. .. .. .. ....	4 2 3	
4. Kerosene .. .. .. .. .. 3 gallons	0 9 3	
5. Matches .. .. .. .. .. 6 dozen	0 7 6	
6. Raw materials and machinery .. .. ....	0 12 6	
		6 13 9

### (b) Artisan

This class comprises many dignitaries like the carpenter and the blacksmith found in some villages only, and the potter, etc., found in every village. The average income of a representative person of this class is Rs. 250 a year. The artisan spends on the same taxed items as the landless labourers; only he spends a little more. The tax burden on him is calculated below:—

Item.	Quantity Consumed.	Tax Paid Rs. a. p.
1. Salt .. .. .. .. .. 36 seers	0 9 0	
2. Sugar .. .. .. .. .. 40 seers	0 13 3	
3. Country Spirit, etc. <sup>2</sup> .. .. .. .. .. ....	4 2 3	
4. Kerosene .. .. .. .. .. 5 gallons	0 15 6	
5. Matches .. .. .. .. .. 9 dozen	0 11 3	
6. Raw materials and Machinery .. .. ....	1 3 6	
		8 6 0

<sup>1</sup> The calculations have been made in the same way as on urban incomes.

<sup>2</sup> For calculations regarding this, see Appendix II.

**(c) Landowners and Tenants<sup>1</sup>**

This group comprises the greatest variety. There are cultivator owners and tenants in Gujarat, whose conditions are little better than those of permanent landless labourers; on the other hand, there are fairly prosperous farmers. The majority of them are somewhere between the two. Their income on an average is Rs. 400 a year. In their case, the biggest tax is land revenue, and this, as we have already seen, does not bear any fixed ratio to income. At most it is roughly assessed in proportion to the rentals the land is likely to fetch, and in many cases, not even this. The cultivator's income from other sources, and the fluctuations in his income every year make the variations wider. Our budgets give Rs. 60 as average revenue paid.

The total tax burden on the farmer works out as follows:—

Item.		Quantity Consumed or Expenditure.	Tax Paid		
			Rs.	a.	p.
1. Salt	.. .. .. ..	40 seers	0	10	0
2. Sugar	.. .. .. ..	50 lbs.	1	0	9
3. Betelnuts	.. .. .. ..	Rs. 1-8-0	0	4	0
4. Country Spirit, etc. <sup>2</sup>	.. .. .. ..	....	2	1	3
5. Kerosene	.. .. .. ..	8 gallons	1	8	9
6. Matches	.. .. .. ..	1 gross	0	15	0
7. Raw materials and Machinery	.. .. .. ..	....	1	12	3
8. Land Revenue	.. .. .. ..	....	60	0	0
			68	4	0

Land revenue being the most important tax in case of a farmer, the additional tax burden that he pays by way of commodity taxation as his income increases does not make much difference to the percentage he pays in taxation. But for purposes of clarity, the tax burden on a farmer with an income of Rs. 1,000 is shown below<sup>3</sup>:—

1. These have been grouped together, because there are many persons in British Gujarat who belong simultaneously to both these groups. The burden of land revenue has been assumed to be on the party which has actually to pay it, according to the terms of the tenancy.

2. For calculations regarding this, see Appendix II.

3. This is based on 25 family budgets of farmers with incomes over Rs. 800.

Item.	Quantity Consumed or Expenditure.					Tax Paid		
	Rs.	a.	p.	Rs.	a.	p.	Rs.	a.
1. Salt .. .. .. .. .. 56 seers 0 14 0								
2. Sugar .. .. .. .. .. 84 lbs. 1 12 0								
3. Betelnuts .. .. .. .. .. Rs. 2-1-0 0 5 0								
4. Dried Fruits .. .. .. .. .. Rs. 2-0-0 0 5 0								
5. Country Spirits, etc. <sup>1</sup> .. .. .. .. .. .... 2 1 3								
6. Kerosene .. .. .. .. .. 12 gallons 2 5 0								
7. Matches .. .. .. .. .. 1 gross, 3 dozen 1 2 9								
8. Foreign Cloth (Japanese) .. .. .. .. .. Rs. 2-0-0 0 8 0								
9. Watches and Clocks .. .. .. .. .. Rs. 1-6-0 0 5 0								
10. Raw Materials and Machinery .. .. .. .. .. .... 3 1 0								
11. Land Revenue .. .. .. .. .. .... 150 0 0								
							162	12 0

(d) Trader

His average income is Rs. 350. The burden on him is worked out below:—

Item.	Quantity Consumed or Expenditure.	Tax Paid.		
		Rs.	a.	p
1. Salt .. .. .. .. ..	38 seers.	0	9	6
2. Sugar .. .. .. .. ..	45 lbs.	0	15	0
3. Betelnuts .. .. .. .. ..	Rs. 1-4-0	0	8	6
4. Country Spirits, etc. <sup>1</sup> .. .. .. .. ..	....	2	1	3
5. Kerosene .. .. .. .. ..	7 gallons	1	5	6
6. Matches .. .. .. .. ..	1 gross	0	15	0
7. Raw Materials and Machinery .. .. .. .. ..	....	1	9	0
		7	11	6

As his income increases, the tax burden on him will increase in the same way as on his city brother. He will only pay a little less by way of commodity taxation because of his village life.

### Total Burden on Village Groups

The percentage burden on rural groups works out as under:—

<sup>1</sup> For calculations regarding this, see Appendix H.

### III. Conclusions

A glance at the table on page 279 showing the total burden of taxation on urban income groups, and at the table on page 283 showing the percentage of incomes paid in taxation by rural groups, leads to the following conclusions:—

(a) Both on grounds of justice and need for impetus to production, the "subsistence minimum" should be exempted from taxation. The exact definition of this term has given rise to many a heated debate; but whatever theoretical differences may exist, there will be a general unanimity that in urban Gujarat an income of Rs. 250 was below this minimum. In spite of this, under our tax system a representative person of this income group had to pay 4.9 per cent of his income in taxation.

(b) It will also be generally agreed that an income of Rs. 500 was perilously near the subsistence level in Gujarat. A person earning that income should, therefore, be taxed lightly, if at all. Our pre-war tax system violated against this canon, and imposed a burden of 4.5 per cent on him.

(c) In urban Gujarat, a few conventional necessities and occasional luxuries could be afforded with an income of Rs. 1,000. It was, therefore, with this income that our tax burden should have begun. According to our calculations, the burden on a person earning Rs. 1,000 in 1938-39 was 3.1 per cent. This was not excessive in itself, but compared with the burden on higher income groups,<sup>1</sup> there was much to be said against it.

(d) The realm of necessity was definitely left far behind at the income of Rs. 2,000. The Rs. 2,000 income group must, therefore, be taxed substantially. Our 1938-39 tax system, however, let off this group lightly. The burden on it was actually lower than those on the lower income groups—2.1 per cent only.

<sup>1</sup> While our assumptions regarding the consumption of country liquor, toddy, etc., might have slightly exaggerated the actual regression among lower income groups, (the possibility that they have softened it is greater) the fact of the regression cannot be denied.

(e) A person earning Rs. 5,000 could afford many comforts in Gujarat; an income of Rs. 5,000 should, therefore, have been taxed at a higher rate than the average of total tax proceeds to total national income. (8 per cent.) But our 1938-39 tax system took only 6 per cent of this income.

(f) With an income of Rs. 10,000 one can proceed far into the realm of luxuries, and at Rs. 30,000 a life of extreme luxuries can be enjoyed. The tax burden should, therefore, be heavy on Rs. 10,000, and should reach very near the maximum on Rs. 30,000. But the burdens on these incomes were only 8.5 per cent and 11.9 per cent respectively. Even on an income of Rs. 1,00,000 the burden was 19.7 per cent only. While different, though reasonable, assumptions regarding luxury taxation will show heavier burdens on higher incomes,<sup>1</sup> the difference will not be appreciable. A much steeper rise in the income tax rates in the earlier stage would be more desirable, and also more productive of revenue. The new income tax rates of 1939-40 have steepened the progression on incomes above Rs. 30,000, but it comes "too late and is too little."

(g) The position with regard to villages groups was much worse. The landless labourer earning about Rs. 150 paid 4.6 per cent by way of taxation; the higher earning village artisan paid 3.4 per cent, and the village trader 2.2 per cent. The comparatively richer farmer was taxed too heavily. Land revenue payments soaked him dry. He was at a great disadvantage compared with a city man earning the same income from non-agricultural sources till he rose high up the income scale, when his exemption from income tax and the comparatively less amount he paid by way of commodity taxation atoned him for payment of land revenue tax. This was somewhere near Rs. 40,000, where the income tax amounted to about 14.2 per cent. A farmer earning more than this income would be at an advantage compared with his colleague in the city because of the lack of progression in land revenue rates. But this

<sup>1</sup> We have assumed that commodity and service taxation reaches its maximum at Rs. 10,000 income.

is only a theoretical advantage as far as the farmers as a class are concerned, for such rich farmers are very few, and apt to be absentee landlords spending most of the time outside their villages. Since a lion's share of the benefits of the limited social expenditure that is incurred by the governments in India goes to the cities, this regression among lower village groups and the high burden of taxation on them are specially reprehensible.

(h) While detailed comparison between our calculations and those regarding the burden of taxation in U.K. given in Appendix J are not possible in view of the differences in *per capita* income, the degree of economic development, the ways of spending of the two Governments and the methods of calculation, a few broad remarks of a general nature can be made. The regression that we observe in the taxation of our lower income groups is also to be found in U.K. But U.K. spends a much greater proportion of its expenditure on Social Services. In our country, we have few Social Services; Old Age Pensions, Sickness Insurance, Unemployment Relief, etc. are conspicuous by their absence. The few services that we have like Education and Public Health are but little developed. Whereas the British Government spent about 25 per cent of its tax revenue on Social Services in 1936,<sup>1</sup> India spent on similar services less than 9 per cent of its tax revenue in 1938-39.<sup>2</sup> The huge social expenditure in Great Britain not only tones down regression of the tax burden among lower income groups, but also returns to the poor more than what is taken from them by way of taxation.<sup>3</sup> Look-

<sup>1</sup> Calculated from Hicks, The Finance of British Government, 1920-36, p. 382 and Statistical Abstract for U. K., 1938.

<sup>2</sup> The expenses on Education, Medicine and Public Health in 1938-39 were Rs. 1,815 lakhs in British India; the total expenses on Revenue Accounts were Rs. 20,746 lakhs. Thus, the expenditure on Social Services amounted to only about 8.7 per cent of the total expenditure.

<sup>3</sup> It has been calculated by Mr. Colin Clark that "the net effects of taxation and local rates in 1935 can be described as a redistribution of £91 millions from the rich to the poor in the form of services, other than those provided for from working class taxation"—National Income and Outlay, p. 148. Even if local rates and local benefits be excluded the result would not be different.

ing to the meagre amount, and the method of administration, the transfer effects of our expenditure on Social Services must be negligible.

It will be observed that in U.K. the progression in tax burden after the first few income groups is much steeper, and for the highest groups the burden is much higher than that in India. The first feature must be immediately introduced in the Indian taxation system; the second should be copied, provided the State takes up a substantial role in providing capital for further development of industries.

## APPENDIX A

### I

#### MAIN ITEMS OF REVENUE OF THE CENTRAL AND THE PROVINCIAL GOVERNMENTS, 1938-39

					In lakhs of Rupees	% to the total Govt. Revenues (Central and Prov.).
<b>Central Government</b>						
Customs	..	..	..	..	40,51	25.0
Central Excise Duties	..	..	..	..	8,60	5.4
(i) Motor Spirit	..	..	..	..	1,24.7	
(ii) Kerosene	..	..	..	..	67.0	
(iii) Sugar	..	..	..	..	4,23.6	
(iv) Matches	..	..	..	..	2,17.9	
(v) Steel Ingots	..	..	..	..	38.2	
(vi) Miscellaneous	..	..	..	..	0.1	
Refund	..	..	..	..	—0.6	
Salt	..	..	..	..	8,12	5.0
Corporation Tax	..	..	..	..	2,04	1.3
Taxes on Income other than Corporation Tax	..				13,74	8.5
Opium	..	..	..	..	51	0.3
Interest	..	..	..	..	74	0.5
Civil Administration	..	..	..	..	1,05	0.6
Currency and Interest	..	..	..	..	58	0.4
Civil Works	..	..	..	..	32	0.2
Receipts from Indian States	..	..	..	..	61	0.4
Other Sources of Revenue	..	..	..	..	2,02	1.2
Posts and Telegraphs (Net Contribution to General Revenue)	..	..	..	..	19	0.1
Railways (Net Contribution to General Revenue)					1,37	0.8

Provincial Governments	In lakhs of rupees	Percentage to Total revenue Central and Provincial
Customs' Duties .. .. .. .. ..	25	1.5
Taxes on Income other than Corporation Tax ..	1,50	0.9
Agricultural Income Tax .. .. .. .. ..	....	....
Land Revenue .. .. .. .. ..	25,94	16.0
Provincial Excises .. .. .. .. ..	13,54	8.4
Stamps, Judicial and Non-Judicial .. .. ..	984	6.1
(a) Non-Judicial Stamps .. .. .. .. ..	338	....
(b) Judicial Stamps .. .. .. .. ..	646	....
Forests .. .. .. .. ..	277	1.7
Registration .. .. .. .. ..	113	0.7
Registration under Motor Vehicles Act .. .. ..	187	1.2
Other Taxes and Duties .. .. .. .. ..	148	0.9
(a) Tax on Entertainments and Luxuries .. .. ..	53	....
(b) Receipts from Electricity Duties .. .. .. ..	40	....
(c) Tobacco Duties .. .. .. .. ..	25	....
(d) Sugar Cess (U. P.) .. .. .. .. ..	28	....
(e) Regulation of Cloth Sales (Madras) .. .. ..	1	....
Irrigation .. .. .. .. ..	918	5.7
Interest Receipts .. .. .. .. ..	176	1.1
Civil Administration .. .. .. .. ..	570	3.5
Civil Works and Mis. Public Improvements .. .. ..	235	1.5
Miscellaneous .. .. .. .. ..	146	0.9
Contributions and Mis. Adjustments between Central and Provincial Governments .. .. ..	308	1.9
Extraordinary Items .. .. .. .. ..	83	0.5
<b>Total Revenue</b>	<b>162,00</b>	

## II

## MAIN ITEMS OF REVENUE OF THE BOMBAY GOVERNMENT, 1938-39

(In Lakhs of Rupees).

Taxes on Income other than Corporation Tax ..	30.0
Land Revenue .. .. .. .. ..	3,54.6
Provincial Excises .. .. .. .. ..	2,89.8
(a) Country Spirits .. .. .. .. ..	1,38.3
(b) Country Fermented Liquor .. .. ..	63.3
(c) Wines and Spirits .. .. .. .. ..	22.8
(d) Receipts from Commercial Spirits .. ..	3.5
(e) Opium .. .. .. .. ..	18.4
(f) Duties on Medicinal and Toilet Preparations containing Alcohol, Opium, etc. .. .. .. .. ..	2.2
(g) Hemp and other drugs .. .. .. .. ..	17.1
(h) Receipts from Distilleries .. .. .. .. ..	25.7
(i) Fines, Confiscations and Miscellaneous .. .. .. .. ..	1.4
Stamps .. .. .. .. ..	1,44.4
(a) Non-Judicial .. .. .. .. ..	77.3
(i) Stamp Duties on Bills of Exchange, Cheques and other Commercial Documents .. .. .. .. ..	19.0
(ii) Other Non-Judicial Stamps .. .. .. .. ..	53.8
(iii) Duty on Impressing Documents .. .. .. .. ..	4.2
(b) Judicial .. .. .. .. ..	67.1
Forests .. .. .. .. ..	40.6
Registration .. .. .. .. ..	14.4
Receipts under Motor Vehicles, etc. .. .. .. .. ..	45.4
Other Taxes and Duties .. .. .. .. ..	64.0
(a)—Taxes on Luxuries .. .. .. .. ..	23.7
(b)—Electricity Duties .. .. .. .. ..	18.0
(c)—Tobacco Duties .. .. .. .. ..	22.4 (20.0 from Bonibay City)
Irrigation, Navigation, Embankment, etc. .. .. .. .. ..	21.9
Debt Service .. .. .. .. ..	72.2
Civil Administration .. .. .. .. ..	91.9
Civil Works .. .. .. .. ..	48.4
Miscellaneous .. .. .. .. ..	20.0
Extraordinary Receipts .. .. .. .. ..	6.8
	<hr/>
	12,45.0

## APPENDIX B

Table showing the main sources of Provincial Revenue in 1938-39 and 1945-46\* by Provinces  
(in lakh of Rupees)

Customs' Duty	Share from Central Income- Tax	Agricultural Income Tax			Land Revenue			Provincial Excises			Stamps (Judicial & non-Judicial)		
		1938-39	1945-46	1938-39	1945-46	1938-39	1945-46	1938-39	1945-46	1938-39	1945-46	1938-39	
Bombay	..	..	30	400	..	..	355	381	290	650	144	260	
Madras	..	..	23	361	..	..	513	577	372	1,411	174	323	
Bengal	..	120	30	406	..	50	324	396	150	660	258	285	
United Provinces	..	..	23	361	..	..	582	656	133	515	128	213	
C. P. & Berar	..	..	8	120	..	..	212	262	64	213	37	57	
Uttar	..	17	8	15	233	..	26	132	138	120	206	105	
Orissa	..	0.1	1	3	48	..	40	51	33	58	18	22	
Assam	..	11.7	11	3	48	..	27	113	178	35	65	18	
N. W. F. P.	..	..	1.5	24	..	..	18	23	9	16	8	11	
Sind	..	..	3	47	..	..	36	82	37	101	16	32	
Punjab	..	..	12	186	..	..	261	333	102	328	78	123	
	250	140	150	2,360	..	97	2,504	3,077	1,354	4,313	984	1,503	
Motor Vehicle Duties			Other Taxes & Duties			(a) Entertainment Tax			(b) Electricity Duties				
	1938-39	1945-46		1938-39	1945-46		1938-39	1945-46		1938-39	1945-46		
Bombay	..	45	47	64	308	24	159	18	18	0.6	40		
Madras	..	81	72	3	574	1	34	0.6	0.6	19	8		
Bengal	..	22	..	10	39	519	18	95	95	10	40		
U. P.	..	12	16	33	147	5	26	0.2	0.2	..	0.2		
C. P. & Berar	..	4	11	1	25	0.4	9	..	..	..	0.3		
Bihar	..	0.3	1	..	42	1	..	..	..	..	..		

	Motor Vehicle Duties		Other Taxes & Duties		(a) Entertainment Tax		(b) Electricity Duties	
	1938-39	1945-46	1938-39	1945-46	1938-39	1945-46	1938-39	1945-46
Orissa	1	0.9	..	..	1	..	..	0.04
Assam	4	8	Nil	..	..	..	..	..
N. W. F. P.	2	3	0.6	..	2	..	..	..
Sind	2	3	3.6	..	0.6	3.4	..	0.02
Punjab	13	13	3	..	50	1.4	12	0.4
					85	2	10	0.2
	187	104	148	1,773	53	350	40	95
(c) Tobacco Duties	(d) Urban Immovable Property Tax		(e) General Sales' Tax		(f) Tax on Motor Spirits		(g) Tax on Trades and Professions	
1938-39	1945-46	1938-39	1945-46	1938-39	1945-46	1938-39	1945-46	1938-39
Bombay	22	29	103	..	..	65	..	..
Madras	..	22	..	..	..	25	..	..
Bengal	..	1.3	..	..	..	50	..	..
U. P.	..	..	..	..	..	20	..	..
C. P. & Berar	..	..	2.1	..	..	0.1	10	0.8
Bihar	..	..	..	..	..	..	..	..
Orissa	..	..	..	..	..	..	..	..
Assam	..	..	0.05	..	..	..	..	..
N. W. F. P.	..	..	1.5	..	..	..	..	..
Sind	0.8	1.4	..	..	..	..	..	..
Punjab	0.6	1.4	..	26	..	38	..	..
	25	56	..	129	..	754	0.1	240
							0.8	12
							12	20
								127.3

\* The 1935-46 figures are budget estimates.

A—Includes compensation from the centre for foregoing the provincial tax measures.

(1) Under the Madras Regulation of the Sale of Cloth Act, 1937.

(2) Under the U. P. Sugar Factories' Control Act.

(3) Tax on Prize competitions.

(4) Jute cess.

## APPENDIX C

### ENGLISH VERSION OF OUR QUESTIONNAIRE RE: FAMILY BUDGETS (WITH AN EXPLANATORY NOTE).

Name of the Head of the Family:

Address:

Religion and Caste:

No. of Family Members staying at the above address:

Adults (above 14):

Children (below 14):

No. of Other Members (including Domestic Servants)  
dining at the above address:

No. of Earners in the Family:

Earners	Occupation	Income	Supplementary Income*		Total Income
			How	How much	
1.					
2.					
3.					
4.					
5.					
6.					

Total Family Income

\* Those families, which stay in their own houses, should add to their incomes that sum which they would obtain if they rented their houses.

## EXPENDITURE

Item	Quantity consumed in a month	Rate	Monthly Expendi- ture	Note
<b>Food :</b>				
1. Salt ..	..			
2. Potatoes ..	..			
3. Sugar ..	..			
4. Cloves ..	..			
5. Nutmegs ..	..			
6. Coconuts ..	..			
7. Betelnuts ..	..			
8. Almonds ..	..			
9. Dates ..	..			
10. Cashewnuts ..	..			
11. Raisins & Currants ..	..			
12. Bidis ..	..			
13. Cigarettes ..	..			
14. Cigars ..	..			
15. Tobacco (for smoking)				
<b>Drinks :</b>				
1. Toddy ..	..			
2. Country Liquor ..	..			
3. Foreign liquor (made in India) ..	..			
4. Alc, Beer, etc..	..			
5. Spirits ..	..			
6. Wines ..	..			
7. Opium ..	..			
8. Bhang ..	..			
9. Ganja ..	..			
10. Charas ..	..			
11. Prepared Tea ..	..			
12. Prepared Coffee ..	..			
13. Patent Medicines ..	..			
<b>Fuel and Lighting :</b>				
1. Kerosene ..	..			
2. Methylated Spirit ..	..			
3. Matches ..	..			
4. Lamps (Glass) ..	..			
5. Lamps (Metal) ..	..			
6. Stoves ..	..			
7. Gas Mantels ..	..			
8. Chimneys ..	..			
9. Electric Globes ..	..			
<b>Wearing Apparels :</b>				
1. Glass Bangles ..	..			
2. Celluloid Bangles ..	..			
3. False Pearls and Beads (Glass) ..	..			
4. Clocks and Watches ..	..			
5. Buttons ..	..			

Item	Quantity consumed in a month	Rate	Monthly Expenditure	Note
<b>Vessels and other Things :</b>				
1. Iron, Steel, Copper, Brass, Bronze, German-silver, Nickel, Aluminium, Tin, Lead, Zinc, etc. .. ..				
2. Chinese Earthenware ..				
3. Cutlery (Scissors, Knives, etc.) .. ..				
4. Glass Vessels .. ..				
<b>Miscellaneous Things :</b>				
1. Bathing Soap .. ..				
2. Toilet Requisites (Comb, Powder, Tooth-Powder, etc.) .. ..				
3. Polish (Boot, Metal, etc.) .. ..				
4. Brush (for combing, tooth-brush, etc.) .. ..				
5. Leather Materials (Artificial Leather) ..				
6. Cards, Toys, Games, etc. .. ..				
7. Penels .. ..				
8. Musical Instruments ..				
9. Painting Materials ..				
10. Petrol .. ..				

Item	No. of articles in use	Cost per article bought	Total cost of articles	Duration for which the article will last	Annual Expenditure
<b>Clothes :*</b>					
<b>Cotton Clothes (For Men)</b>					
1. Dhotis ..					
2. Lungis ..					
3. Turbans ..					
4. Caps ..					
5. Bandis ..					
6. Shirts ..					
7. Ganjifrocks					
8. Coats ..					
9. Hats ..					
10. Pants ..					
11. Ties ..					
12. Kafanis ..					

\* The tailoring charges should not be added here.

Item	No. of articles in use	Cost per article bought	Total cost of articles	Duration for which the article will last	Annual Expenditure
Clothes— <i>Contd.</i>					
13. Jackets ..					
14.					
15.					
Total ..					
(For Women)					
1. Saris ..					
2. Odhanies ..					
3. Cholies ..					
4. Kabjas ..					
5. Chanias ..					
6. Sadaras ..					
7.					
8.					
9.					
10.					
11.					
Total ..					
(For Girls)					
1. Odhanies ..					
2. Cholis ..					
3. Chanias ..					
4. Zabhalas ..					
5. Lenghas ..					
6. Chaddis ..					
7. Frocks ..					
8.					
9.					
10.					
Total ..					
(For Boys)					
1. Dhotis ..					
2. Coats ..					
3. Pants ..					
4. Shirts ..					
5. Zabhalas ..					
6. Caps ..					
7. Pyjamas ..					
8. Chaddis ..					
9.					
10.					
Total ..					
1. Sheets ..					
2. Pillars ..					
3. Kerchiefs ..					
4. Towels ..					
5. Napkins ..					
6. Sheets for Beds ..					

Item	No. of articles in use	Cost per article bought	Total cost of articles	Duration for which the article will last	Annual Expenditure
<b>Clothes—<i>Contd.</i></b>					
7. Charasas					
8. Table Cloth					
9. Stocks ..					
Total ..					
<b>Total Cotton Clothes.</b>					
<b>Silk Clothes :</b>					
1. ..					
2. ..					
3. ..					
4. ..					
Total ..					
<b>Artificial Silk Clothes :</b>					
1. ..					
2. ..					
3. ..					
4. ..					
5. ..					
Total ..					
<b>Woollen Clothes :</b>					
1. Sals ..					
2. Blankets ..					
3. ..					
4. ..					
5. ..					
6. ..					
Total ..					
1. Shoes ..					
2. Umbrellas ..					
3. Overcoats ..					

Item	Annual Expenditure
1. Paper (Writing) .. .. ..	
2. Stationery (Copy books, Drawing Books, etc.) .. .. ..	

Item	No. of articles in use.	Cost price when bought	Duration of the article
1. Radios ..	..	..	
2. Fans (Electric) ..	..	..	
3. Batteries ..	..	..	
4. Electric Wires ..	..	..	
5. Meters ..	..	..	
6. Motors ..	..	..	
7. Cycles ..	..	..	
8. Motor Cycles ..	..	..	
9. Refrigerators ..	..	..	
Monthly Rent ..	..	..	
Electric Charges (Monthly) ..	..	..	
Expenses on Cinemas, Dramas, etc. (Monthly) ..	..	..	
 Tax		Amount	
Income Tax ..	..		
Land Revenue ..	..		
Customs and Excise Duties ..	..		
New Property Tax ..	..		
Electricity Tax ..	..		
Entertainment Duty ..	..		
Total Tax Burden ..	..		

The above questionnaire was mainly formed with a view to obtain the consumption of the taxed commodities and services of various income groups. The general rule followed was to include all consumption goods which brought in a duty of more than two lakhs of rupees in 1938-39 in British India. Where, however, the articles were such as were consumed mainly in the bigger cities like Bombay, and their consumption in smaller cities was insignificant, e.g. foreign biscuits, cakes, confectionery, canned fruits, etc., they are omitted. Some articles, whose consumption, it was felt might be higher in Gujarat, were included though they yielded less than 2 lakhs of rupees. A few commodities though not taxed were included to demarcate the expenditure on some taxed commodities

from the expenses on them, or to obtain indirectly the consumption of some taxed item.

The progress of our studies and the enquiry revealed some defects in the questionnaire, which had to be amended in some places. In case of goods, where differential duties were levied and where the production figures of home-produced goods were not available, or where foreign goods formed almost a separate commodity as in case of cotton clothes, the families were asked not only their total expenditure on the item as a whole but also their separate expenditures on home-produced and foreign parts. In order to facilitate the task, the items on which either too little was spent, or which could not be distinguished clearly, had to be grouped together, e.g. the items almonds, dates, cashewnuts, raisins and currants had to be placed together under "dried fruits". Toddy and country liquor were combined in one; so also, ale, beer, etc., spirits, and wines were grouped together as "foreign liquor". Opium, bhang, ganja and charas were also combined. Many persons could not clearly distinguish between silk and artificial silk, which had to be put together. The item of motor vehicle taxation had to be included later on. It was found during the course of the inquiry that there were some items like cocums, nutmegs, methylated spirit, gas-mantels, buttons, foreign bathing soap, foreign woollen clothes, motor cycles, refrigerators, etc., where the expenditure of the various income groups was likely to be too small to make the tax of any moment. These were, therefore, omitted.

The relevant results of this inquiry have been shown in Appendix E.

## APPENDIX D

### DETAILS REGARDING FAMILY BUDGETS COLLECTED

The first question that confronted us in our inquiry was the number of budgets we should aim at collecting. Having regard to the purpose of the inquiry and the time at our disposal, we thought that 16,000 budgets—800 from towns and 800 from rural areas—would be enough. For rural areas, a smaller proportion was selected because of the greater uniformity in village life. Our original plan would have meant approaching 0.36 per cent of urban families and 0.15 per cent of rural families.

For this purpose, we had to undertake an extensive tour of Gujarat lasting for about 6 months—March-June, 1941, and September-October, 1941. Both in our city and village work, we received unstinting co-operation from parties too numerous to be enumerated here. But special mention must be made of Messrs Chimanlal C. Narkhi and Muljibhai Bhagat for their invaluable assistance in Kaira District; of Dahyabhai Naik, Secretary, Bhil Seva Mandal and his colleagues for work in the Panchmahals; of Chandrashankar Bhat and Dhanprasad Vin for work in the Broach District; of Hitendra K. Desai for rural work in the Surat District, and of Bhogilal Lala for rural work in the Ahmedabad District.

#### (a) Urban Work

The budgets collected in the cities came fairly near to our expectations. We were able to get about 750 budgets, 636 of which we found valid for our purpose. Throughout the task of collection, the need of representing all the varied occupations in urban areas was kept before us. Our being armed from Bombay with a number of introductions on different parties in Gujarat with altogether different cir-

cles of contact was very useful to us in securing this variety.

The family budgets had to be collected from various income groups. The two lowest income groups comprised most of the persons, and from these two groups, the largest number of budgets had to be collected. But the greater diversity found in consumption habits of the higher income groups made us collect a proportionately larger number of budgets from them. The following table shows the budgets collected from various income groups.

Income Groups	Number of Budgets Collected.
150—300	192
301—600	185
601—1,200	130
1,201—2,500	98
2,501—6,000	56
6,001—12,000	25

In the collection of budgets, due representation was given to various districts. The following table will make this clear:—

Name of District	Population (in 000's)	Percentage to total population in Urban Gujarat	No. of Budgets Collected	Percentage to total budgets collected from Urban Gujarat
Ahmedabad .. ..	400	49%	302	44%
Broach .. ..	69	9%	85	12%
Kaira .. ..	126	16%	104	15%
Panch Mahals .. ..	73	9%	68	10%
Surat .. ..	146	17%	127	19%

The division of the urban population in any district among the various population sub-groups was taken into account in selecting the number and type of cities to be visited in each district and the number of budgets to be collected from each. The Ahmedabad urban population being concentrated only in one place, all the budgets of the Ahmedabad District were collected from Ahmedabad City itself; in Surat District, budgets were gathered mainly from Surat and some from Bulsar, Rander and Mandvi (84, 16, 16 and 11 respectively); in the Panchmahal District,

budgets were collected from the two big towns—Dohad (33) and Godhra (35); the Broach District budgets were obtained from Broach, Ankleshwar, Jambusar and Amod (35, 22, 18 and 10 respectively); from the Kaira District having the most widespread urban population, a number of towns were chosen—Nadiad (42), Anand (16), Kapadvanj (15), Akor (14), Mehmedabad (8) and Kaira (9).

The following two tables showing the sub-division of urban population of each district and the number of budgets collected from those sub-groups will give a vivid idea of the work:—

Name of District	Population in towns of					
	5,000- 10,000	10,001- 20,000	20,001- 50,000	50,001- 1,00,000	Over 1,00,000	Total Popula- tion.
(All figures in thousands)						
Ahmedabad ..	92	33	..	..	310	435
Broach ..	11	24	34	..	..	69
Kaira ..	59	56	85	..	..	150
Panchmahals ..	12	..	57	..	..	69
Surat ..	17	32	..	99	..	148

Name of District	Number of Budgets collected from towns with popula- tion of					
	5,000- 10,000	10,001- 20,000	20,001- 50,000	50,001- 1,00,000	Over 1,00,000	Total No. Collected
Ahmedabad ..	..	..	..	..	302	302
Broach ..	10	40	35	..	..	85
Kaira ..	81	31	42	..	..	104
Panchmahals ..	..	..	68	..	..	68
Surat ..	11	32	..	84	..	127

### (b) Rural Work

We collected only about 250 budgets from rural areas. We could have gathered more, but we felt that the results would, in no way, be more reliable, and would mean a needless waste of time. We were content with selecting two or more representative villages from each district on the advice of people well familiar with rural areas. We

got the idea of the income and expenditure habits of various classes within the villages from the leading men there, and then proceeded to make a first hand contact with representative persons of the various classes. We proceeded to ask them questions based on the questionnaire, but most of them could only give broad information, e.g. that they took tea once or twice. From such broad answers or detailed answers elicited by methods which could not survive the full test of laws of evidence, an idea of their expenditure had to be obtained, and the questionnaire filled in. We obtained 250 budgets in this way—95 from the farmers, 62 from the village artisans, 47 from the traders, and 46 from labourers. These answers, while very valuable in giving and correcting impressions, are certainly no unalloyed gold. Their averages have to be interpreted with due care and reserve.

The villages visited were:—Dabhan, Narsanda and Khadol in Kaira District, Mirakhedi, Dagaria, Kalinga and Biyanmali in Bhil areas of the Panchmahal District; Kalak and Sajod in Broach District; Kosamba, Amalsadi and Abhrama in Surat District, and Kerala and Vadrod in the Ahmedabad District:

## APPENDIX E

Table showing the Consumption of Important Taxed Items of Various Income Groups in Urban Gujarat.

Item	Quantity Consumed Annually or Annual Expenditure					
	For Income between Rs. 150-300.	For Income between Rs. 301-600.	For Income between Rs. 601-1200.	For Income between Rs. 1201-2501.	For Income between Rs. 2501-5000. Average Income = Rs. 496; size of the Family = 3.8	For Income between Rs. 5000. Average Income = Rs. 1,678; size of the Family = 3.9
Salt (in seers)	..	..	..	..	..	..
Sugar (in lbs.)	..	..	..	..	..	..
Betcheuts (in Rs. a. p.)	..	..	..	..	..	..
Dried Fruits	..	..	..	..	..	..
Cigarettes	..	..	..	..	..	..
Toddy and Country Liquor (Rs. a. p.)	..	..	..	..	..	..
Opium, Bhang, Ganja and Charas (,,)	..	..	..	..	..	..
Foreign Liquor (in Rs. a. p.)	..	..	..	..	..	..
Patent Medicine (Foreign) (,,)	..	..	..	..	..	..
Kerosene (in gallons)	..	..	..	..	..	..
Matches (in grosses and dozens containing 40 matches on an average)	..	..	..	..	..	..
Lamps (Glass and metals) (in Rs. a. p.)	..	..	..	..	..	..
Glass Gloves and Chimney (,,)	..	..	..	..	..	..
Electric Globes (in Rs. a. p.)	..	..	..	..	..	..
Glass Bangles (,,)	..	..	..	..	..	..
Watches and Clocks (in Rs. a. p.)	..	..	..	..	..	..
Gramophones (,,)	..	..	..	..	..	..

## APPENDICES

Quantity Consumed Annually or Annual Expenditure						
For Income between Rs. 150-300.		For Income between Rs. 301-600.		For Income between Rs. 601-1200.		For Income between Rs. 1201-2501.
For Income Average Income = Rs. 263 ; size of the Family = 3.8	For Income Average Income = Rs. 400; size of the Family = 4.0	For Income Average Income = Rs. 975; size of the Family = 3.0	For Income Average Income = Rs. 1,058; size of the Family = 4.1	For Income Average Income = Rs. 1,450; size of the Family = 4.5	For Income Average Income = Rs. 2500. Average Income = Rs. 1,850; size of the Family = 4.5	For Income Average Income = Rs. 6000. Average Income = Rs. 9,850; size of the Family = 4.0
..	..	..	..	..	..	..
Petrol (in gallons) <sup>1</sup>	..	2.0.0	4.0.0	6.0.0	10.0.0	15.0.0
Cotton Clothes (Japanese) <sup>2</sup> (in Rs. a. p.)	..	..	2.0.0	5.0.0	15.0.0	20.0.0
Cotton Clothes (British) <sup>3</sup>	..	2.4.0	7.0.0	14.0.0	19.0.0	37.0.0
Silk and Artificial Silk	..	..	..	4.0.0	12.0.0	15.0.0
Radios	..	..	0.14.0	1.6.0	9.0.0	25.0.0
Cars	..	..	2.11.0	5.4.0	11.13.0	18.0.0
Cycles <sup>4</sup>	..	1.2.0	..	12.0.0	20.0.0	32.0.0
Entertainments	..	..	..	..	..	..

1. The figures were obtained in 267 cases.

2. From 325 budgets.

3. From 313 budgets only.

Table showing the Tax Burdens of Customs and Excise Duties on Various Income Groups in Urban Gujarat

Item	Income Scales						Rs. 10,000
	Rs. 250	Rs. 500	Rs. 1,000	Rs. 2,000	Rs. 5,000	Rs. a. p.	
II. Customs & Excise Duties							
Salt ..	0 9 0	0 11 0	0 12 6	0 13 0	0 13 0	0 13 0	0 13 0
Sugar ..	1 4 0	1 12 0	3 0 0	3 8 9	3 12 0	4 7 0	4 7 0
Butternuts ..	0 4 0	0 4 3	0 4 6	0 6 0	0 6 0	0 7 0	0 7 0
Dried Fruits ..	..	0 2 9	0 6 0	0 11 0	0 13 0	1 5 0	1 5 0
Cigarettes ..	..	..	..	..	..	..	..
Country Liquor, Colly, Opium, etc.	5 11 3	11 6 9	11 6 9	5 13 3	11 10 0	17 8 0	17 8 0
Foreign Liquor ..	..	..	..	..	..	..	..
Patent Medicines ..	1 2 6	0 2 6	0 7 3	1 10 3	0 13 6	29 8 6	29 8 6
Kerosene ..	1 2 5	1 5 6	1 13 3	2 8 0	1 8 0	1 8 0	1 8 0
Matches ..	1 2 9	1 6 6	1 14 0	1 14 0	2 11 3	3 7 6	3 7 6
Watches and Clocks ..	..	0 2 6	0 8 0	1 1 0	1 10 3	1 10 3	1 10 3
Porcelain Vessels, etc. ..	0 0 6	0 3 0	0 7 3	0 12 0	1 14 0	3 3 0	3 3 0
Games ..	0 1 0	0 4 0	0 12 0	1 4 0	2 8 0	3 12 0	3 12 0
Petrol ..	..	..	..	..	..	..	..
Cotton Clothes ..	..	0 8 6	1 4 3	2 1 9	4 3 9	6 1 6	6 1 6
Silk and Artificial Silk Clothes ..	..	0 5 0	0 15 0	1 13 9	2 8 6	4 14 9	4 14 9
Radio ..	..	..	..	1 0 0	3 0 0	3 12 0	3 12 0
Motor Cars ..	..	..	..	..	..	..	..
Raw Materials and Machinery ..	1 12 0	2 12 3	5 0 0	9 13 0	30 2 6	76 4 3	76 4 3
Total Percentage to Income ..	11 15 9 4.8%	21 8 6 4.3%	28 14 9 2.9%	36 0 0 1.8%	115 6 6 2.3%	206 7 6 3.2%	206 7 6 3.2%

## APPENDIX G

Tables showing the Tax Burdens on Various Income Groups in Urban Gujarat  
 I—Tax Burden according to 1938-39 Income Tax Rates

Items	Income Scales										Rs. 30,000
	Rs. 250	Rs. 500	Rs. 1,000	Rs. 2,000	Rs. 5,000	Rs. 10,000	Rs. 15,000	Rs. 20,000	Rs. 30,000		
	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	
I. Tax on Income	..	..	..	1 0	0	0	0	0	0	0	
II. Customs and Excise Duties	11 13	9	21 8	6	28 14	9	36 0	0	115 6	6	
III. Electricity Duty	0 5	0	1 0	0	1 8	0	3 0	0	6 12	0	
IV. Entertainments	..	..	..	0 4	0	1 8	0	3 0	0	5 0	0
V. Motor Vehicle Tax	..	..	..	..	..	..	8 0	0	25 0	0	
Total	..	..	12 4	9	22 8	6	30 10	9	41 8	0	
% to Income	..	..	46.9	4.5	3.1	2.1	6.1	8.5	9.0	11.0	

Items	Income Scales										Rs. 30,000
	Rs. 50,000	Rs. 1,00,000	Rs. 3,00,000	Rs. 5,00,000	Rs. 10,00,000	Rs. 20,00,000	Rs. 30,00,000	Rs. 40,00,000	Rs. 50,00,000	Rs. 60,00,000	
	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	
I. Tax on Income	8,068 9 0	19,354 3 0	83,112 0	01,73,380 12 0	4,50,630 5	010,26,514 12 0	015,96,393 4 0	..	..	..	..
II. Customs and Excise Duties	..	..	..	..	..	..	..	..	..	..	..
III. Electricity Duty	..	..	..	..	..	..	..	..	..	..	..
IV. Entertainments	338 0 0	338 0 0	338 0 0	338 0 0	338 0 0	338 0 0	338 0 0	338 0 0	338 0 0	338 0 0	338 0 0
V. Motor Vehicle Tax	..	..	..	..	..	..	..	..	..	..	..
Total	..	8,400 9 0	19,692 3 0	83,450 0 0	01,73,727 12 0	4,55,974 5	010,26,832 12 0	015,96,731 4 0	..	..	..
% to Income	16.8	10.7	27.8	31.7	45.7	51.3	53.2	..	..	..	..

## APPENDIX G (Contd.)

## II. Tax Burden according to 1939-40 Income Tax Rates

Income Rs.	Income Tax Rs. a. p.	Other Taxes Rs. a. p.	Total Tax Burden Rs. a. p.	Percent- age to Income
2,000	...	40 8 0	40 8 0	2
5,000	164 1 0	338 2 6	297 3 6	5.9
10,000	554 11 0	338 0 6	892 11 6	8.9
15,000	1,179 11 0	338 0 6	1,517 11 6	10.1
30,000	3,836 0 0	338 0 6	4,174 0 6	13.9
50,000	9,148 0 0	338 0 6	9,486 0 6	19.0
1,00,000	26,023 0 0	338 0 6	26,361 0 6	26.4
3,00,000	1,11,961 0 0	338 0 6	1,12,299 0 6	37.4
5,00,000	2,15,086 0 0	338 0 6	2,15,424 0 6	43.1
10,00,000	5,11,961 0 0	338 0 6	5,12,299 0 6	51.2
20,00,000	11,05,711 0 0	338 0 6	11,60,049 0 6	55.3
30,00,000	10,99,461 0 0	338 0 6	16,99,799 0 6	56.7

## APPENDIX H

MEASUREMENT OF THE BURDEN OF PROVINCIAL  
EXCISE DUTIES ON RURAL GROUPS

(a) **Country Liquor:** The total duty from country liquor in British Gujarat was Rs. 1,942 thousands in 1938-39.<sup>1</sup> We have already estimated the duty from "urban" areas at 1,154 thousands.<sup>2</sup> The proceeds from this duty in "rural" areas in 1938-39 were, therefore, Rs. 788 thousands. Allowing for the difference in the definition of rural areas between ourselves and the Excise Report (according to the Report, 150 thousand more population in rural areas), the rural proceeds were about Rs. 650 thousands.

In the villages, the landless labourers are the most given to drink—drinking being among many of them a social custom. While among rural artisans drinking is a little less universal, the greater expenditure of the smaller

<sup>1</sup> Report on the Administration of Excise Department, 1938-39, Imperial Table I, Col. 6, p. 62.

<sup>2</sup> Chapter X.

number which drinks makes up for this. The tenants, the owner cultivators, and the village traders spend much less on drink and probably pay only about  $\frac{1}{2}$  the duty per head by way of excise taxation.

Unfortunately, no occupational classification of rural parts in British Gujarat is available, but we have a classification of the whole of British Gujarat. According to the 1931 census about 308 thousand principal earners were occupied in cultivating their own lands, 37 thousands as tenant cultivators, and 149 thousands as agricultural labourers in British Gujarat. Most of these must have been in rural Gujarat. Taking all of these as residing in rural Gujarat<sup>1</sup>, and taking the number of principal earners in rural Gujarat as 686 thousand,<sup>2</sup> 192 thousand principal earners will remain to be classified. These will be rural artisans and other miscellaneous workers. The total number of families in rural Gujarat was 539 thousands in 1931. Working out from these the duty would work out at Rs. 1-9-9 and 0-13-0 respectively for the two groups.

**(b) Toddy and other Fermented Liquors:** We have already assumed that the toddy duty per capita in villages is 1/3rd that in cities. On this assumption as well as other further assumption that the contribution by the various rural classes is the same as in (a), the cultivator's family pays Re. 0-14-6 by way of toddy taxation, and the landless labourers' and rural artisans' families Rs. 1-13-0.

**(c) Opium and Other Hemp Drugs:** On the same basis as of toddy, the duty works out at Re. 0-5-9 per cultivator's family and Re. 0-11-6 in case of landless labourers and rural artisans.

The restrictive excise burden on various rural groups then works out as under:—

<sup>1</sup> This is a slight overestimation, for some of these must be residing in towns of 5,000-10,000. But it is compensated for by our not taking village traders.

<sup>2</sup> This is worked out on the assumption that the ratio to the total rural population (of principal earners) will be the same as that for British Gujarat as a whole i.e. 3.5.

	Country Spirit	Toddy, etc.	Opium and Other Hemp Drugs.	Total Excise Burden
Landless Labourer ..	Rs. 1 9 9	Rs. 1 13 0	Rs. 0 11 6	Rs. 4 2 3
Village Artisan ..	1 0 0	1 13 0	0 11 6	4 2 3
Farmer ..	0 13 0	0 14 6	0 5 0	2 1 3
Village Trader ..	0 13 0	0 14 6	0 5 0	2 1 3

## APPENDIX I

Table showing the Burden on Various Rural Groups.

Tax Burden through	Landless Labourer	Village Artisan	Landowner and Tenant		Village Trader Income =Rs.350
	Average Income =Rs.150	Average Income =Rs.250	Average Income =Rs.400	Income =Rs.1000	
(a) Salt ..	Rs. 0 7 6	Rs. 0 9 0	Rs. 0 10 0	Rs. 0 14 0	Rs. 0 9 0
(b) Sugar ..	0 6 0	0 13 3	1 0 0	1 12 0	0 15 0
(c) Betelnuts ..	....	....	0 4 0	0 5 0	0 3 0
(d) Dried Fruits ..	....	....	....	0 5 6	....
(e) Toddy, Country Spirit, Opium, Bhang, Ganja, etc. ..	4 2 3	4 2 3	2 1 3	2 1 3	2 1 3
(f) Kerosene ..	0 9 3	0 15 6	1 8 0	2 5 0	1 5 6
(g) Matches ..	0 7 6	0 11 3	0 15 0	1 2 9	0 15 0
(h) Watches & Clocks ..	....	....	....	0 5 6	....
(i) Japanese Cloth ..	....	....	....	0 8 6	....
(j) Raw Materials and Machinery ..	0 12 6	1 3 0	1 12 3	3 1 0	1 9 0
(k) Land Revenue ..	....	....	60 0	0 150 0	....
Total % of Income ..	6 13 9	8 6 9	69 4	162 12 6	7 11 6
	4.6	3.4	17.1	16.3	2.2

## APPENDIX J

## The Tax Burden in U. K.

Income £	1903-4			1913-14			1918-19			1925-26			1930-31			1937-38			1941-42		
	Half Earned All Invest- ment		Half Earned All Invest- ment		Half Earned All Invest- ment		Half Earned All Invest- ment		Half Earned All Invest- ment		Half Earned All Invest- ment		Wholly from Invest- ment		Wholly from Invest- ment		All Earned		All Earned		
	All Earned	A	B	A	B	A	B	A	B	A	B	A	B	A	B	A	B	A	B		
Taxation as a percentage of Income																					
50	8.7	0.5	8.0	8.8	0.5	11.1	11.0	13.0	10.9	13.1	13.1	18.1	16.7	18.1	16.7	28	25.25	28	25.25		
100	5.0	6.8	5.4	6.0	9.0	10.2	11.6	12.7	11.3	13.2	13.2	16	16.16	16	16.16	24	23.23	24	23.23		
150	4.5	5.7	4.4	5.6	9.0	10.2	11.6	12.7	11.3	13.2	13.2	15	15.16	15	15.16	22	21.52	22	21.52		
200	4.8	6.0	4.0	5.3	7.9	9.1	10.2	11.3	9.6	11.7	11.7	14	20.22	14	20.22	31	37.40	31	37.40		
500	5.3	0.5	4.4	7.1	10.2	13.5	6.2	8.4	5.1	10.1	10.1	10.1	28.31	10	28.31	40	47.53	40	47.53		
1,000	6.1	7.8	5.2	8.3	16.9	20.6	11.0	14.4	10.9	20.7	20.7	20.7	24	32.38	24	32.38	46	53.61	46	53.61	
2,000	5.7	7.4	4.9	8.4	24.0	28.1	15.2	19.3	17.5	30.8	30.8	30.8	33	39.52	59	39.52	59	64.75	59	64.75	
5,000	5.5	7.5	6.7	9.0	36.3	39.2	23.2	29.5	28.2	47.7	47.7	47.7	41	47.67	70	47.67	70	73.79	70	73.79	
10,000	5.0	7.6	8.0	11.8	42.5	46.3	31.2	40.1	37.6	63.8	63.8	63.8	50	55.70	82	55.70	82	83.86	82	83.86	
20,000	4.9	7.7	8.3	13.0	47.6	52.3	37.5	48.7	45.3	63.4	63.4	63.4	58	63.70	91	63.70	91	92.94	91	92.94	
50,000	4.8	8.0	8.4	13.6	50.0	58.2	44.4	57.7	53.2	117.9	117.9	117.9	58	63.70	91	63.70	91	92.94	91	92.94	

1. For higher income groups in real life, the burden will be somewhere between figures in A and B, as their income will be partly earned and partly unearned.

2. The burden on the lower income groups is higher in case of earned incomes because of the flat social insurance contributions.

3. In case of all unearned incomes there are double estimates because of the different assumptions regarding savings made during one's lifetime.

Vide Chapter IX.